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By Jost J. Schmitt*

For decades, considerable legislative and legal inquiry has focused on automobile dealers. This inquiry has sought, among other things, to uncover their contractual and factual relationships with automobile manufacturers. The sum of these relationships is a franchised distribution system. However, the systems's legal implications have never received a thorough treatment. This article undertakes to focus on the dealer-manufacturer relationship from the viewpoint of the consumer, who is the ultimate beneficiary or victim of the current distribution system.

This article will summarize those elements of structure, conduct and performance which characterize the competitive situation in the automobile industry. The existence of high barriers to entry will be given particular attention. This discussion will be followed by an analysis of current distribution methods and their contribution to product differentiation. These economic factors serve as the foundation for a new legal approach to the distribution systems imposed by the automobile producers. It will be argued that the systematic relationship between the manufacturers and their respective dealer networks constitutes a combination within the meaning of section 1 of the Sherman Act. Consequently, the management of this combination, whether unilateral or bilateral, is susceptible to a test of reasonableness because restraints of trade are inherent in every selective distribution system. Additionally, special attention will be given to the legality of the location clause. All features of the automobile retail level, however, will not be scrutinized for their antitrust law relevance. For example, the entire complex of customer restrictions, fleet sales and price discrimination are

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omitted. Yet, the areas analyzed reveal that the automobile distribution system is far from being free of practices condemned by the antitrust laws.

The Structure of the American Automobile Industry and the Performance of Its Member Firms

Since the incorporation of Ford Motor Company in 1903, 2600 different makes of American passenger cars have come—and mostly gone.[1] The number of automobile manufacturers reached its peak at 88 in 1921. A rapid decline followed. By 1935, only 10 manufacturers remained.[2] This number dwindled to 5 by 1960. Since the exit of Studebaker-Packard in 1966,[3] General Motors, Ford, Chrysler and American Motors factually represent the domestic passenger car industry. These four manufacturers produce 12 makes of automobiles.[4]

1. Comment, *Antitrust Law and the New Industrial State: An Application to Automobile Distribution Practices*, 4 U.S.F.L. REV. 78, 81 (1969) [hereinafter cited as *Distribution Practices*].

2. For a detailed depiction of the early development of the automobile industry see R. EPSTEIN, THE AUTOMOBILE INDUSTRY (1928) [hereinafter cited as EPSTEIN]; E. KENNEDY, THE AUTOMOBILE INDUSTRY (1941) [hereinafter cited as KENNEDY]; A. NEVINS & F. HILL, FORD: THE TIMES, THE MAN, THE COMPANY (1954); L. SELTZER, A FINCIAL HISTORY OF THE AMERICAN AUTOMOBILE INDUSTRY (1928) [hereinafter cited as SELTZER].

3. A good description of the demise of Studebaker Packard is given in C. EDWARDS, DYNAMICS OF THE UNITED STATES AUTOMOBILE INDUSTRY 70-103 (1965) [hereinafter cited as EDWARDS, DYNAMICS]. *See also* L. WHITE, THE AUTOMOBILE INDUSTRY SINCE 1945 (1971) [hereinafter cited as WHITE].

4. The market shares of the domestic firms, including foreign makes, from 1960 are:

Source: Automotive News, various editions.

	1960	1961	1962	1963	1964
G.M.	43.7%	46.5%	51.9%	51.0%	49.1%
Ford	26.6%	28.5%	26.3%	24.9%	26.0%
Chrysler	14.0%	10.8%	9.6%	12.4%	13.8%
American M.	6.4%	6.3%	6.1%	5.7%	4.7%
Studeb./Pack.	1.6%	1.2%	1.1%	0.8%	0.3%
Foreign/Misc. Dom.	7.7%	6.7%	5.0%	5.2%	6.1%

	1965	1966	1967	1968	1969
G.M.	50.1%	48.1%	49.6%	46.7%	46.8%
Ford	25.5%	26.1%	22.2%	23.7%	24.3%
Chrysler	14.7%	15.4%	16.1%	16.2%	15.1%
American M.	3.5%	3.0%	2.8%	2.7%	2.5%
Studeb./Pack.	0.1%	—	—	—	—
Foreign/Misc. Dom.	6.1%	7.4%	9.3%	10.7%	11.3%

	1970	1971	1972 (first six months)
G.M.	39.73%	45.16%	44.91%
Ford	26.42%	23.52%	24.29%
Chrysler	16.09%	13.71%	13.74%
American M.	3.03%	2.50%	2.92%
Foreign/Misc. Dom.	14.73%	15.11%	14.14%

(Source: Automotive News, Aug. 21, 1972, p. 4)

Three of these manufacturers are industrial giants by all methods of comparison.

Little has to be said about the relative size of the Big Three within American business enterprises.[5] Furthermore, the automobile industry is immensely important to the American economy as a purchaser, employer and taxpayer. Numerous other areas of the economy are affected, directly or indirectly, by the industry. While no serious discussion of aspects of this industry should fail to recognize and appraise its influential position as one of the cores of the nation's economic welfare, this must not mean that the industry's participants are immune from a close check of their behavior as well as their performance.

Such scrutiny is necessary because the situation in the automobile industry cannot be labeled as competitive in the structural economic sense. The model situation that no single producer is a big enough part of the total market to have any personal influence on the market price is far from being fulfilled. In fact, the passenger car industry bears all structural characteristics of a tight oligopoly. Indeed, it is cited often as *the* classic example of an industry where few sellers act in full knowledge of their mutual interdependence. Each seller is aware that certain business decisions strongly affect its competitors and might be unprofitable or even disadvantageous for the initiator in the course of retaliatory or duplicative response.

Bigness of an industry or a firm, although it might automatically be watched with suspicion as jeopardizing "[t]he general objective of the antitrust laws . . . [which is the] promotion of competition in open markets,"[6] is not necessarily detrimental to the goals of an optimally functioning economy. Rather, the discussion boils down to the question of how much private economic power can permissibily be substituted for the free force of the market place without losing the values usually attributed to competition. Competition leads to efficient allocation of resources, high product quality and reasonable prices, consumer choice among various types and qualities of goods and services. It enhances producer freedom to enter lines of production that offer

5. According to the rank by sales in Fortune Magazine's list of the 500 largest United States industrial corporations, 1954-68, General Motors was always number 1, Ford vacillated between 2 and 3, Chrysler recently maintained number 5 after a dropback in the early 1960s and even "dwarf" American Motors ranked among the 63 largest corporations betwen 1959 and 1965 before falling back to 131 by 1968. *Hearings on the Role of Giant Corporations in the American and World Economies Before the Subcomm. on Monopoly of the Senate Select Committee on Small Business,* 91st Cong., 1st Sess., pt. 1, at 4 (1969) [hereinafter cited as *Hearings, Giant Corporations*].

6. REPORT, ATTORNEY GENERAL'S NAT'L COMM. TO STUDY THE ANTITRUST LAWS 1 (1955) [hereinafter cited as REPORT: ANTITRUST LAWS].

greater profits or other advantages. Laborers are benefited because they are given greater freedom of choice in selecting occupations and employers. Finally, competition provides businesses with incentive to adopt more efficient modes of production and distribution and to develop new or improved products in order to gain customers.[7] Nonetheless, "[s]ome power [is necessary], both because of inescapable limitations to the process of atomization and because power is needed to do the job the American public expects of its industrial machinery."[8]

"By all but the pathologically romantic, it is now recognized that this is not the age of the small man."[9] Advanced technologies have necessitated the expansion of firms beyond the smallness which is one of the prerequisites for the existence of a perfectly competitive market. The task of the antitrust laws cannot be and is not seen as turning back the wheel of industrial development to a state where pure market forces no longer are tampered with by size, interdependence and output-price determinations of firms. However, according to the basic ideology of the antitrust laws, the model of perfect competition still serves as a standard that yields the best possible results for the community. Deviations from this standard will be tolerated as long as competition in an industry is still workable in a pragmatic sense,[10] as long as its results do not fall too short of the ideal of perfect competition[11] and as long as clearly better alternatives are not conceivable or practically attainable.[12]

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7. J. ANDERSON, POLITICS AND THE ECONOMY 159-60 (1966) [hereinafter cited as ANDERSON].

8. E. MASON, ECONOMIC CONCENTRATION AND THE MONOPOLY PROBLEM 387 (1957).

9. J. GALBRAITH, THE NEW INDUSTRIAL STATE 32 (1967) [hereinafter cited as GALBRAITH].

10. The theory of workable competition was pioneered in Clark, *Toward a Concept of Workable Competition* in READINGS IN THE SOCIAL CONTROL (1942). It "does not provide a standard of legality under any of the antitrust laws." REPORT: ANTITRUST LAWS, *supra* note 6, at 316. However, some of the tests developed in the theory permit the systematic study of market facts. *Id.*

11. The most significant measures of performance are: "(a) the volume of employment it provides; (b) the efficiency of production, and thus the aggregate volume of output secured with any given volume of employment; (c) the relative stability, or freedom from fluctuations, of output and employment over time; (d) the rate of growth of output over time, or the rate of 'progress'; (e) composition of aggregate output as among alternative goods to be produced; and (f) the distribution of income among various potential income recipients." J. BAIN, INDUSTRIAL ORGANIZATION 13 (2d ed. 1968) [hereinafter cited as BAIN, INDUSTRIAL ORGANIZATION].

12. Two different aspects of workable competition are embraced by this statement: the purely economic weighing of actual performance against an economic ideal and the evaluation of possible and practical means to improve performance. See Markham, *An Alternative Approach to the Concept of Workable Competition*, 40 AM.

The General Relationship Between Industry Structure and Performance

For more than two decades, economists constantly have tried to explore the relationship between the structural elements of American industries and their actual performance.[13] Before giving a sketchy description of the performance of the automobile industry as the background for an economic and legal appraisal of this industry's distribution system, the findings of general economic studies must be reviewed. The methodologically most convincing of these studies was conducted by Joe S. Bain.[14] For forty-two census industries[15] he ascertained the relation between the five year (1936 to 1940) average annual profit rate on equity and the 1935 concentration ratios. While his study did not reveal any significant *continuous* relationship between profits and concentration, Bain made two remarkable findings. First, in industries where the eight largest sellers in the aggregate had transgressed the seventy percent market share threshold, the annual average profit amounted to 11.7 percent on equity.[16] This was contrasted with less concentrated industries which showed an average annual profit rate on equity of only 7.7 percent.[17] Moreover, this significant difference was caused almost entirely by differences between the profit rates of the *larger* firms in the respective industries.[18] Furthermore, Bain derived from his study an indication that concentration was not the only structural cause for excess profits:[19] "Extremes both of seller concentration

ECON. REV., Jun. 1950, 349, at 361. *But see* C. EDWARDS, MAINTAINING COMPETITION: REQUISITES OF A GOVERNMENTAL POLICY 9-10 (1949). These aspects are not without difficulties. While allocative efficiency, profits and selling costs are measurable, other aspects of market performance lack meaningful standards. BAIN, INDUSTRIAL ORGANIZATION, *supra* note 11, at 419-25. However, there is little disagreement that competition is the fundamental premise of antitrust law. *See, e.g.*, Northern Pacific Ry. v. United States, 356 U.S. 1, 4-5 (1958); Standard Oil Co. v. United States, 221 U.S. 1, 52 (1911).

13. *E.g.*, Bain, *Relation of Profit Rate to Industry Concentration: American Manufacturing, 1936-40*, 65 Q. J. ECON. 293 (1951) [hereinafter cited as Bain, *Industry Concentration*]; Collins & Preston, *Concentration and Price-Cost Margins in Food Manufacturing Industries*, 14 J. INDUST. ECON. 226 (1966); Mann, *Seller Concentration, Barriers to Entry, and Rates of Return in Thirty Industries, 1950-1960*, 48 REV. ECON. & STATS. 296 (1966) [hereinafter cited as Mann]; Weiss, *Average Concentration Ratios and Industrial Performance*, 11 J. INDUST. ECON. 237 (1963).

14. Bain, *Industry Concentration*, *supra* note 13.

15. Census industries are groups of firms—a branch of trade—with either similar products or processes as categorized by the Bureau of Census and the Internal Revenue Service. *Id.* at 294, 304.

16. *Id.* at 319.

17. *Id.*

18. *Id.* at 319-20.

19. For a definition of excess profits, see *id.* at 387.

and of *difficulty of entry* may be tentatively viewed as at least quasi-independent characteristics of market structure that are conducive to unworkable performance in the matter of profits."[20]

Bain's findings seemingly are supported by two later studies.[21] It is, therefore, not surprising that his study markedly influenced those who tried to help the antitrust laws in coping with the problems created by highly concentrated industries. The application of section 1 of the Sherman Act[22] requires some kind of collusive behavior in restraint of trade, and the prerequisites for proving monopolization or an attempt to monopolize[23] are rather difficult to meet. Since interdependent behavior by tight oligopolists is likely to yield the same results in terms of performance as collusive conduct, the antitrust laws turned out to be a blunt weapon in the fight for workable competition in highly concentrated industries. Accordingly, a new *structural* approach as advanced by Bain himself was eagerly picked up by other scholars.[24] In recommending legislation to supplement present antitrust statutes, Kaysen and Turner,[25] as well as the Task Force on Antitrust Policy,[26] relied heavily on the statistically demonstrated connection between high concentration and profits. These factors are clearly traceable aspects of market performance.[27] If these proposals had grown into law, the automobile industry, save for political reasons, hardly would have escaped a structural antitrust attack. The persistently high seller concentration, the small number of competitors and the complete absence of successful domestic entry for half a decade would have been a sufficient basis for an assault against the Big Three.

If things were this clear, little need currently might be felt for appraisal of the distribution system, which is only a small segment of the automobile industry. Rather, the development of the industry after the application of a structural remedy could be observed before zeroing in

20. *Id.* at 457 (emphasis added).

21. J. BAIN, BARRIERS TO NEW COMPETITION 195-97 (1956) [hereinafter cited as BAIN, BARRIERS]; Mann, *supra* note 13.

22. 15 U.S.C. § 1 (1970).

23. *Id.* § 2.

24. *E.g.*, Mueller, *The New Antitrust: A 'Structural' Approach*, 1 ANTITRUST L. & ECON. REV. 87 (1967). *Contra*, Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L. REV. 1562 (1969).

25. C. KAYSEN & D. TURNER, ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS 24-43, 275-91 (1959) [hereinafter cited as KAYSEN & TURNER]

26. REPORT, WHITE HOUSE TASK FORCE ON ANTITRUST POLICY (1968) reprinted in *Hearings, Giant Corporations, supra* note 5, at pt. 1A, at 877.

27. In both proposals, industries with a four firm concentration ration ov seventy percent would be subject to antitrust attack. KAYSEN & TURNER, *supra* note 25, at 267; *Hearings, Giant Corporations, supra* note 5, at 890-91.

on the distribution system as one possible source of the industry's entrenchment against new competition and positively stimulated performance. Unfortunately, things are not this clear. Brozen's recent reminder[28] casts a shadow on the supposedly brightly illuminated operation table for a ruthless structural surgery. His study discloses a lack of persistence of high rates of return in highly concentrated industries, thereby denying the asserted basis for the deconcentration recommendations. In fact, Bain himself had warned against an overinterpretation of his findings because his sample[29] was biased towards concentrated industries in the first place.[30] Brozen objects to Bain's studies on the basis that the economy was not at an equilibrium level during the periods for which Bain's tests were conducted. Furthermore, these tests did not cover a period sufficiently long enough to exclude the possibility of windfall profits and rewards for innovations. Absent persistent supracompetitive profits in highly concentrated industries, Brozen's notion seems to be that the antitrust laws should not be applied hastily, but only after self-regulation by natural market forces fails.[31]

Brozen's objections are not necessarily the ultimate word in the discussion about industry concentration and profits. However, his criticism certainly is a reminder that a good degree of caution should accompany any step toward a rigid, hasty and undifferentiated application of structural remedies to highly concentrated industries. Therefore, even if antitrust policy were regarded simply as a kind of economic engineering project,[32] and even if the economic springs of the policy could be regarded as solely determining, economists have not yet provided antitrust law enforcers with a sound, unequivocal theoretical basis for attacking big business as such without an individual observation of the performance in every single industry. The available empirical evidence is still contradictory and hardly one-sided with regard to the relationship between industry structure and performance.

The Performance of the Automobile Industry

While an attack on high concentration alone might be of question-

28. Brozen, *The Antitrust Task Force Deconcentration Recommendation,* 13 J.L. & ECON. 279 (1970) [hereinafter cited as Brozen].

29. Bain had profit data for 149 census industries on hand. Bain, *Industry Concentration, supra* note 13, at 314.

30. *Id.* at 309; Brozen, *supra* note 28, at 281-83.

31. *See also* Turner, *The Scope of Antitrust and Other Economic Regulatory Policies,* 82 HARV. L. REV. 1207, 1215 (1969).

32. *Compare* Burk & Bowman, *The Crisis in Antitrust,* 65 COLUM. L. REV. 363 (1965) *with* Blake & Jones, *Towards a Three-Dimensional Antitrust Policy,* 65 COLUM. L. REV. 422 (1965). *See also* A. NEALE, THE ANTITRUST LAWS OF THE U.S.A. 430 (2d ed. 1970).

able value, the automobile industry verifies the hypothesis that high seller concentration[33] and high barriers to entry[34] go hand in hand with persistently high industry profits.[35] Also, the industry's performance can be classified as workably competitive only by the most benign observer. It was a long time ago that the Federal Trade Commission made the remarkably favorable characterization:

> Active competition among automobile manufacturers, although some of them have made very large profits, gave to the public improved products, often at substantially reduced prices. In the automobile industry this has been especially true of those manufacturers who are able to obtain large volume of production through competitive improvement in motor vehicle construction, style, performance, and safety, particularly in the low-priced class. Such competition has been the basis for the remarkable growth of the industry.
>
> Consumer benefits from competition in the automobile-manufacturing industry have probably been more substantial than in any other large industry studied by the Commission.[36]

Since World War II, few scholars have found equally kind words as Donald Moore and Edward A. Mason, who conceded the automobile industry a "remarkably good"[37] and a "relatively good"[38] performance.[39] This article cannot scrutinize every sector of the car manufacturers' behavior and performance. However, if the industry's performance could be characterized as generally agreeable, the possible disadvantages of the current distribution system to the consumer would appear in a decidedly milder light. Therefore, some sketchy remarks about conduct and performance are necessary.[40]

While collusive pricing behavior among the automobile producers is not evident,[41] the prices charged by all domestic firms in the industry

33. Note 4 *supra*.

34. See text accompanying notes 75-87 *infra*.

35. Note 51 *infra*.

36. FEDERAL TRADE COMM'N, MOTOR VEHICLE INDUSTRY, H.R. DOC. No. 468, 76th Cong., 1st Sess., 1074 (1939) [hereinafter cited as FTC MOTOR VEHICLE REPORT].

37. Moore, *The Automobile Industry* in THE STRUCTURE OF AMERICAN INDUSTRY 274, 323 (W. Adams ed., rev. ed. 1954) [hereinafter cited as Moore].

38. Mason, *The Current Status of the Monopoly Problem in the United States*, 62 HARV. L. REV. 1265, 1282 (1949).

39. The positive evaluations may have been correct at the time. The industry still contained eight domestic manufacturers, restyling ran at a slower pace, and soaring profits could be explained as a natural consequence of the supply shortage during and immediately after World War II.

40. For a fairly comprehensive account of the competitive situation in the automobile industry, see *Hearings on the Question: Are Planning and Regulation Replacing Competition in the American Economy? Before Subcomms. of the Senate Select Comm. on Small Business*, 90th Cong., 2d Sess. (1968) [hereinafter cited as *Hearings, Planning, Regulation and Competition*].

41. BAIN, INDUSTRIAL ORGANIZATION, *supra* note 11, at 346. Collusive suppres-

are roughly similar for comparable cars. Adjustments of quoted prices to those of competitiors are common.[42] Parallel pricing policies and formulas have led to an almost complete stifling of price competition.[43] General Motors is obviously recognized as the price leader. It does not behave like a true short-run profit maximizer but rather employs a cost-plus-profit scheme—that is, a target pricing technique.[44] Direct labor and material costs plus unit overhead costs are projected on the basis of a normal or standard volume which is generally set at eighty percent of capacity.[45] A twenty percent rate of return on net worth is loaded on this synthetic unit cost. The pursuit of this pricing objective is only feasible under the expectation that total industry demand, industry capacity and the respective market shares of the producers will remain relatively constant. "What the competition is doing is taken into account, but, it appears, almost as an after-thought."[46] Since demand for new automobiles does not seem to be more than slightly elastic with respect to prices[47] and since price competition is virtually nonexistent, the company's goal is to offer the public a highly developed car for an acceptable price rather than an acceptable car for the lowest possible price. In determining the production costs, cost minimization considerations are less important than a calculation of what final price the market will bear. Costs are adjusted to this price minus the established profit target. Lower costs tend to be passed to the consumer in the form of improvements rather than in lower prices.[48] Utmost production efficiency under these circumstances would be aston-

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sion was attacked in the field of the development of automotive emission control devices. United States v. Automobile Mfrs. Ass'n, Inc., 307 F. Supp. 617 (C.D. Cal. 1969).

42. *See, e.g.*, Wall Street Journal, Oct. 22, 1956, at 6, col. 3; SUBCOMM. ON ANTITRUST AND MONOPOLY OF THE COMM. ON THE JUDICIARY, 85TH CONG., 2ND SESS. REPORT ON ADMINISTERED PRICES: AUTOMOBILES 61-65 (1958) [hereinafter cited as REPORT, ADMINISTERED PRICES].

43. For a detailed evaluation of the pricing behavior of the Big Three, see WHITE, *supra* note 3, at 105-35.

44. Wall Stree Journal, Dec. 10, 1957, at 1, col. 6 (How Auto Firms Figure Their Costs to Reckon the Price Dealers Pay); L. WEISS, ECONOMICS AND AMERICAN INDUSTRY 355-56 (1961) [hereinafter cited as WEISS].

45. *But see Hearings, Planning, Regulation and Competition, supra* note 40, at 218 (General Motors' Chevrolet division profit target related to approximately fifty-five percent of maximum physical capacity); REPORT ADMINISTERED PRICES, *supra* note 42, at 107, table 16.

46. WHITE, *supra* note 3, at 112.

47. However, demand is sensitive with respect to income changes. *See* Atkinson, *Consumer Markets for Durable Goods*, 32 SURVEY OF CURRENT BUS., Apr. 1952, at 19; Suits, *The Demand for New Automobiles in the United States 1929-1956*, 50 REV. ECON. & STATS., Aug. 1958, at 273.

48. Moore, *supra* note 37, at 321.

ishing.[49] The public is refused the choice between acceptable and technologically advanced cars.

Unfortunately, any discomfort over the price rigidity and the price determination methods used in the automobile industry is increased by an observation of literally all discernible aspects of performance such as profits, product quality and safety, and rate and pattern of progressiveness.[50] The Big Three's profits during the last decade consistently have exceeded rates of return which are deemed fair or normal for manufacturing industries.[51] Despite generous profits, no entry of a domestic producer has taken place since the abortive attempt of Kaiser-Frazer in 1945.

With the disappearance of price differentials on comparable models, nonprice competition assumes a very important role in the struggle for an increased volume and market share. Since the early 1920s, frequent model changes have become common. These changes require retooling of production lines. Originally, model changes emerged from significant developments in technology. Later, they became mostly merchandising devices designed to enhance sales, coming in ever-shorter periods.[52] In fact, model proliferation has reached the point

49. "Organization slack" is likely to occur. *Hearings, Planning, Regulation and Competition, supra* note 40, at 919-20.

50. Sales promotion is not considered here because it is closely related to distribution.

51. From 1957 to 1968, net income as a percentage of net worth for the four domestic automobile manufacturers was as follows:
Source: *Hearings, Giant Corporations, supra* note 5, pt. Ia, at 729 (compiled from MOODY'S INDUSTRIAL MANUAL and from FORTUNE)

	American Motors	Chrysler	Ford	G.M.
1957	not available	16.38	12.78	17.51
1958	18.97	-4.89	5.02	12.82
1959	31.62	-0.80	17.26	16.50
1960	21.61	4.56	14.86	16.75
1961	10.45	1.57	13.09	14.82
1962	13.72	8.50	14.06	21.94
1963	13.84	17.55	13.14	22.35
1964	9.41	19.05	12.61	22.83
1965	1.95	14.75	15.65	18.51
1966	loss	11.12	12.98	20.55
1967	loss	10.92	1.83	17.57
1968 (6 months)	not available	7.61	8.07	9.93

This comparison might be deemed inconclusive because of special risk rewards that must be conceded to the automobile industry. However, risk rewards do not play an important part in the automobile industry. Moreover, the argument would not explain why GM with the least vulnerable position earns even higher profits than Ford and Chrysler.

52. For a recent examination of the competitive impact of annual model changes and its antitrust policy implications see Note, *Annual Style Change in the Automobile Industry as an Unfair Method of Competition*, 80 YALE L.J. 567 (1971) [hereinafter cited as *Annual Style Changes*].

that it can hardly be explained by consumer demand.[53] The enormous expenditures for model changes[54] are reflected only to a miniscule degree in real improvements.[55] The Big Three claim that a great deal of innovation has been going on in the industry, providing the customer with higher value, more safety and greater reliability of his car. Certainly, the public has received an improved car over years. However, "an industry's progressiveness can be properly evaluated only in terms of how progressive it has been *relative to its opportunities.* The question is how well it has exploited the available opportunities for invention and innovation."[56] Most recent technological improvement came from outside the big firms. Small producers and component suppliers have done more than a proportionate share of pioneering.[57] This dismal record has carried over into safety, expense of repair and reliability.[58] Despite this crude compilation of industry performance, one conclusion can be drawn. The structure of the industry has paralyzed the strive for agreeable performance to a regrettable degree.

Barriers to Entry in the Automobile Industry

Certainly no direct regression line—no one-to-one relationship—exists between the vigor of competition and the number of firms in an industry. An addition of one or two independent competitors might hardly be felt in terms of performance. However, a given industry is

53. "Last year a Yale University physicist calculated that since Chevy offered 46 models, 32 engines, 20 transmissions, 21 colors (plus nine two-tone combinations) and more than 400 accessories and options, the number of different cars that a Chevrolet customer conceivably could order was greater than the number of atoms in the universe. This seemingly would put General Motors one notch higher than God in the chain of command. This year, even though the standard Chevrolet never accounts for less than two-thirds of Chevy's sales, Chevy is offering still more models (a total of 50) and options, indicating that while they may not be increasing their lead over Ford, they are pulling away from God." Higdon, *The Big Auto Sweepstakes,* N.Y. Times, May 1, 1966, § 6 (Magazine), 36 at 97.

54. $1.56 billion or about $195 per automobile in 1969. *Annual Style Changes, supra* note 52, at 576, 577 n.45.

55. *Id. But see* Moore, *supra* note 37, at 299 (suggesting this is due in part to the public's being wary of radical or experimental changes).

56. BAIN, INDUSTRIAL ORGANIZATION, *supra* note 11, at 419.

57. REPORT, ADMINISTERED PRICES, *supra* note 42, at 24; WHITE, *supra* note 3, at 258. Examples of innovations which orignated outside the Big Three are: the automatic transmission, the all-steel body, hydraulic valve lifters, four wheel brakes and adjustable seat belts. More recent innovations include the disc brake and Wankel engine. *But see* Senator Dirksen's dissent, REPORT, ADMINISTERED PRICES, *supra* note 42, at 280-81.

58. *See Hearings, Planning, Regulation and Competition, supra* note 40, at 470 recording Ralph Nader's testimony that the Chevrolet Corvette is so expensive to repair that General Motors owned GM Motor Insurance Company will only write policies on the Corvette at very high prices. *See generally id.* at 471-96.

likely to behave less interdependently and perform noticeably better with eight or ten relatively small competitors than with three giant competitors. This is provided that the size of the three competitors is not required by economies of scale as a minimum for optimal efficiency.

Undoubtedly, technological requirements prohibit a splitting of the automobile industry into atomistic units. Therefore, "[a] law requiring that the automobile industry consist of 50 or 100 firms and have a standardized product would be in the same category with a law preventing the tide from coming in."[59] However, three studies lead to the conclusion that the minimum optimal scale in the automobile industry would allow roughly a dozen efficient competitors.[60] The first of these studies was conducted by Bain. He based his estimates of optimal scale on survey questionnaire responses from officials of the firms engaged in the automobile industry.[61] His main finding with respect to scale economies was that an optimal plant complex in the auto industry would have to be designed for a production of 300,000 to 600,000 units per year. At the time of his study, this production would approximate five to ten percent of the annual national output. Even if the minimum optimal scale has increased over the years,[62] Bain's findings imply that ten to twenty optimally sized firms could operate profitably in the industry.

Since the firms in the automobile industry were not interested in publicizing their plant and firm scale curves, Bain could not determine exactly their leftward slopes. However, he reported that 300,000 units per annum was a low estimate of that needed for productive efficiency in any one line. There are probably added advantages up to 600,000 units.[63] At an output of 150,000 units per year, costs are moderately higher than at 300,000 to 600,000 units, but annual production below 60,000 units is clearly uneconomical.[64] Moreover, Bain indicated that

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59. WEISS, *supra* note 44, at 373.

60. BAIN, BARRIERS, *supra* note 21, at 244-47; WHITE, *supra* note 3, at 286; *Hearings on Administered Prices, Automobiles Before the Subcomm. on Antitrust Trust and Monopoly of the Senate Comm. on the Judiciary*, 85th Cong., 2d Sess., pt. 6, at 2851 (1958) [hereinafter cited as *Hearings, Administered Prices*]. But see G. MAXCY & A. SILBERSTON, THE MOTOR INDUSTRY 82 (1959) (estimating optimal output to be one million units per year).

61. BAIN, BARRIERS, *supra* note 21, at 49-51.

62. Before World War II, 250,000 units were sufficient to make full use of special tools. Paul Hoffman, then president of Studebaker, testified that 110,000 units would permit competition with the Big Three. *Hearings Before the Temporary Nat'l Economic Comm.*, 76th Cong., 2d Sess., pt. 21, at 11218 (1940).

63. BAIN, BARRIERS, *supra* note 21, at 245.

64. *Id.* Achieving a great deal more competition in the automobile industry may require higher costs per unit. Therefore, a more reliable description of the left-

"the critical stage in plant economies is evidently found in the production of coponents and not in assembly. In assembly alone, from 60,000 to 180,000 units per annum is considered optimal. . . ."[65] This, of course, is not to say that entry as an assembler is still as feasible as in the 1910s.

The second study on scale economies was presented by George Romney, then president of American Motors.[66] Based on studies conducted by his company, he testified that a minimum optimal scale plant would produce 180,000 to 220,000 units annually, including engines and bodies:

> A company that can build between 180,000 and 220,000 cars a year on a 1-shift basis can make a very good profit and not take a back seat to anyone in the industry in production efficiency . . . .
>
> [M]y point is that when you get up to 180,000 to 200,000 cars a year, the cost reduction flattens out, from a manufacturing cost standpoint, and from 360,000 to 400,000 on up it is a negligible thing. . . .
>
> So all this talk about the disadvantage of lack of volume in relationship to tooling costs is grossly exaggerated.[67]

Romney concluded by saying that on a two shift basis, an annual production of 360,000 to 440,000 units would achieve additional small economies. However, beyond that volume only theoretical and insignificant reductions in manufacturing costs were possible.[68]

In tune with these earlier estimates of scale economies is White's determination.[69] While an optimal rate in final assembly was found to be between 200,000 to 250,000 units a year on a two shift basis and while the casting process seemed to be adaptable to most otherwise feasible scales of production, it "is in stamping, where the best sheet metal dies have useful lives of around 400,000 stampings, that the largest volume economies are to be found."[70] However, White added risk considerations as a new dimension to his scale determination, maintaining that the survival chances for a firm vastly improve if the firm can rest its fate on two pillars. "The minimum efficient size to ensure survival in the long run, then, is a firm manufacturing somewhere around 800,000 units a year, split into two makes of 400,000 units each. . . . [T]he major benefit would be from the diversification of

ward slope of the scale curve would be desirable. For an attempt at such a description, see WHITE, *supra* note 3, at 39.

65. BAIN, BARRIERS, *supra* note 21, at 245.

66. *Hearings, Administered Prices, supra* note 60, pt. 6, at 2342-2988.

67. *Id.* at 2851-53.

68. *Id.* at 2851.

69. WHITE, *supra* note 3, at 38-53.

70. *Id.* at 38.

risk."[71] This introduction of a risk diversification element is sound under current market conditions. After a structural remedy has split the industry into a dozen firms of about equal size, it would become irrelevant. But even nowadays, the lower estimate is not incompatible with the competitive situation in the automobile industry: a survival *possibility* as opposed to a survival *insurance* should be sufficient to induce entry if there were no additional barriers.

If these estimates are approximately correct, the sizes of the Big Three are not necessitated by technological requirements and economies of scale. At first glance, the other impression might be that in light of the minimum volume required, entry for a domestic newcomer would be feasible. Nonetheless, since World War II only Kaiser Motor Company seriously attempted to enter. This attempt failed. Entering at a time of nearly unsatiable postwar demand, Kaiser seemed assured of success. It commanded the talents of experienced executives, the backing of a multimillion dollar industrial empire and the inherited production and distribution facilities of Graham-Paige Motors, an operative automobile organization. Through stock offerings, loans from private and government agencies and financial resources derived from other Kaiser enterprises $100 million were raised. Within eleven months Kaiser produced a car which was praised for its engineering achievement and proved to be a style leader. Its market share rose to nearly five percent of industry sales by 1948. Yet, the venture was doomed to fail, and by 1954—nine years after entry—Kaiser withdrew from production.[72]

The reasons for Kaiser's failure strikingly demonstrate that a minimum scale of production is not the only barrier to entry for domestic newcomers. Many factors contributed. Consumer acceptance actually decreased over several years, leading to a drop in volume and scale economy disadvantages. Kaiser was unable to finance the launching of a new model in 1950. The trade-in values of Kaiser cars were considerably inferior to those of the established producers. Finally, Kaiser failed to establish an effective nationwide network of financially strong and sufficiently experienced automobile dealers to promote sales and offer services.[73] "The new entrant concern was, after the first couple of years, absorbing increasing operating losses

71. *Id.* at 49-50.

72. *Id.* at 67-72; *Annual Style Change, supra* note 52, at 586-87.

73. BAIN, INDUSTRIAL ORGANIZATION, *supra* note 11, at 285; WHITE, *supra* note 3, at 68-70; Lanzillotti, *The Automobile Industry*, in W. ADAMS, THE STRUCTURE OF AMERICAN INDHSTRY 311, 328-29 (3d ed. 1961) [hereinafter cited as Lanzillotti]; *Annual Style Change, supra* note 52, at 587-88.

ranging upward from $10 million annually, and apparently at last decided not to throw further good money after bad in an attempt to establish a foothold in the industry."[74]

Since Kaiser's exit, the enormous capital requirements for meeting the scale economies in production and retail distribution as well as the massive sales promotion outlays for establishing consumer acceptance of the new product have not declined. On the contrary, George Romney's estimates from 1958 seem to be fairly conservative: $576 million for a newcomer based on an annual production of 250,000 automobiles.[75] On the basis of producing 800,000 units annually, White estimated the capital requirements of a new entrant at slightly over one billion dollars.[76] In addition to this, the capital requirement for a dealer and distributor network was estimated to be $326.2 million.[77] In the past, these requirements have been supplied by the dealers themselves. Nevertheless, it seems appropriate to include part of this sum in the total.[78] The wholesale level has become fully integrated by the Big Three.[79] An entrant may also need to duplicate another concept of the Big Three: the establishment of some factory-owned or supported retail stores in strategically important locations. Moreover, because the financially strong dealer potential is allegedly absorbed primarily by the established producers[80] and because interfactory dealerships are rather rare,[81] a newcomer would have to back its dealerbody with loans during the starting phase of contractual forward integration. Thus, barriers to entry have increased since Kaiser's abortive attempt at entry. These barriers are heightened by the necessity to establish a distribution network.

In the light of Kaiser's experience and the exorbitant sums necessary to enter, potential newcomers hardly will feel encouraged to start production. Economists have concluded that barriers to entry in the

74. BAIN, INDUSTRIAL ORGANIZATION, *supra* note 11, at 285.

75. REPORT, ADMINISTERED PRICES, *supra* note 42, at 17, table 1.

76. WHITE, *supra* note 3, at 61.

77. REPORT, ADMINISTERED PRICES, *supra* note 42, at 16 n.28 (based on a dealer body of 3,500 members). 2,500 to 3,000 dealers are necessary for national coverage. WEISS, *supra* note 44, at 343.

78. *Contra*, Lanzillotti, *supra* note 73, at 328.

79. Even American Motors has taken the first step towards bypassing the traditional middleman distribution concept by delivering parts and accessories directly to the dealer. AUTOMOTIVE NEWS, Mar. 20, 1972, at 1 (AMC to Bypass Wholesalers with New Aftermarket Line).

80. Mueller, *Sources of Monopoly Power: A Phenomenon Called "Product Differentiation"*, 2 ANTITRUST L. & ECON. REV. Summer 1969, at 80-81 [hereinafter cited as Mueller].

81. *See* note 166 *infra.*

automobile industry are "very high and perhaps insuperable,"[82] "impregnable,"[83] and "almost insurmountable."[84] "Billion dollar corporations are not common phenomena, and forming one from scratch would be virtually impossible. . . . The high risks of entry and the dismal history of past attempts would surely scare away even the most intrepied investors. . . . On absolute capital cost requirement alone, one can consider entry at an efficient scale as effectively blockaded."[85] Even if the capital requirements for entry were met, the newcomer would, during the first decade of its operation, probably incur product differentiation disadvantages that could easily amount to fifteen million dollars or more break-in losses annually—all invested without any guarantee of ultimate success.[86] Only small assemblers of special sport cars might be able to secure a tiny corner of the market, but they cannot be considered a serious contribution to stronger competition in the passenger car industry. Representatives of companies which have developed alternative automobile propulsion systems have unanimously agreed in their testimony before congressional committees that entry by firms offering such innovations is not economically feasible.[87]

Some Remedy Considerations

The first reaction to the competitive situation in the automobile industry is the suggestion of a structural remedy. The Big Three could be broken into parts small enough to assure competitively more aggressive behavior and better performance. However, two factors must be considered. First, speedy antitrust action, even if based on solid legal ground, is wasted if the proposed remedies are not thoroughly considered in light of all their ramifications. Merely busting up the Big Three or only General Motors might easily prove useless. Accompanying measures would have to be taken regarding the companies' interrelations with their financing companies, their distribution systems and their vertical backward integration. The result of an ill-formulated remedy decree in the early *Tobacco* case[88] should remain as a constant

82. BAIN, INDUSTRIAL ORGANIZATION, *supra* note 11, at 287.

83. *Hearings, Planning, Regulation and Competition, supra* note 40, at 907.

84. *Id.* at 920 n.6. See also WEISS, *supra* note 44, at 377 (speaking of virtual exclusion of new firms).

85. WHITE, *supra* note 3, at 61.

86. BAIN, BARRIERS, *supra* note 21, at 307-8; BAIN, INDUSTRIAL ORGANIZATION, *supra* note 11, at 286-87.

87. *Annual Style Change, supra* note 52, at 590. Only a radical change in technology or a significant lowering of raw material costs might reduce the necessary scales of entry and accordingly the capital requirements. WHITE, *supra* note 3, at 64.

88. United States v. American Tobacco Co., 221 U.S. 106 (1911).

warning.[89] Second, the dissolution of one or all of the Big Three, however commendable from a long-run economic standpoint, is a hot political question. For example, in 1967, Assistant Attorney General Donald F. Turner was prepared for an antitrust suit against General Motors but was stopped by President Johnson's disapproval.[90] The prepared litigation would have focused on early General Motors' mergers. It was directed towards splitting off the Chevrolet Division plus perhaps one or two assembly divisions and enough parts manufacturing and other facilities to make the split-off companies effective competitors.

Even if this intended legal action had proven successful, having four giants in the place of three provides no advantage. The social gain, however, might have been found in an attack on General Motors' widely recognized superior efficiency as compared with Ford and Chrysler. This seems to be an utterly puzzling statement since superior efficiency—within limits—normally is regarded as very desirable. However, General Motors, perhaps in fear of antitrust actions[91] in case of an increase of its market share considerably above the fifty percent border, seems to have never fully exploited its efficiency. The recognition of this superiority, reflected in the consistently higher profit margins, might have convinced Ford and Chrysler that passive or reactive behavior might fit their role better than not accepting General Motors as the leader in terms of prices and style changes. On a level of approximately equal efficiency, it might be vaguely hoped that the other firms become more active and aggressive within the limits of the still present oligopolistic interdependence.

As an alternative to a structural remedy, the foreign competitors

89. "One complaint against the decree concerned the continued position of the Trust owners as major stockholders in all the successor companies: 'The main feature of the plan is to divide the corporation . . . into three parts; these three parts [will] be owned by the same persons, in the same proportions, and to be controlled by the same individuals [whom] the Supreme Court held to have combined in a violation of the law. . . .

Furthermore, the distribution of brands according to the plants whch manufactured them resulted in initial monopolies in various branches of the industry." R. TENNANT, THE AMERICAN CIGARETTE INDUSTRY 64 (1950), *quoting from* Brandeis, *An Illegal Trust Legalized,* 21 WORLD TO-DAY 1440 (1911). Indeed, there is ample evidence that industry performance did not improve after dissolution on the Trust. See American Tobacco Co. v. United States, 328 U.S. 781 (1946).

90. *See Hearings, Planning, Regulation and Competition, supra* note 40, at 253-54 (testimony of Ralph Nader).

91. Shubik, *A Game Theorist Looks at the Antitrust Laws and the Automobile Industry,* 8 STAN L. REV. 594, 625 (1956). For possible business reasons, see Moore, *supra* note 37, at 315.

could be relied upon to wake and shake up the sleeping giants.[92] Indeed, some recent improvements in American automobiles are certainly the result of the introduction of innovations to the American public by European or Japanese manufacturers. Presently, the American consumer is given a choice between big, luxurious flagships and small, handy and thrifty compact cars. Amazingly enough, the imports have not turned out to be "in the long run unlikely to capture more than a limited corner of the American market. . . ."[93] Their market share has been steadily increasing since 1962, and even after a short dropback due to President Nixon's incisive economic strategy in 1971, they have almost regained their old strength.[94]

However, no exclusive reliance should be placed on the competitive stimulation provided by foreign producers. In a world of very delicate monetary balance and economic interconnection, foreign manufacturers tend to be especially sensitive and vulnerable to import aggravations. Furthermore, as a matter of general political consideration, backing domestic industry is certainly preferable to feeding foreigners. If, therefore, improvements in price-competitive vigor and consumer-biased performance can conceivably be derived from changes at home, any promising suggestion should be followed without hesitation.

In the previous discussion of the desirability, necessity and availability of direct structural remedies, little has been said about one crucial barrier to entry in the automobile industry—product differentiation. If the current distribution system noticeably contributes to product differentiation and thereby to the height of existing entry barriers, one might be intrigued to think of entirely new ways of distribution. An erosion of existing product differentiation and the resultant height of entry barriers, however, is a very lengthy process, and temporary function breakdowns of the distribution might be considered too high a price for a faintly improved long-run prospect of successful domestic entry. Therefore, equal consideration should be given to the impact of the distribution system on the *current* competition—for instance, whether this system stifles intrabrand competition or unduly hinders consumers in gaining access to cars and services.

92. *See* AUTOMOTIVE NEWS, Mar. 20, 1972, at 26.

93. BAIN, INDUSTRIAL ORGANIZATION, *supra* note 11, at 287; *accord, Hearings, Planning, Regulation and Competition, supra* note 40, at 920 n.6.

94. AUTOMOTIVE NEWS, Aug. 21, 1972, at 4 (Healthy Sign Noted in Import Registrations).

Automobile Distribution and Product Differentiation

Product differentiation is one source of barriers to entry. Supposedly it is not the least important source. To the extent that product differentiation exists, a seller has latitude to raise its price above that of its interbrand competitor—actual or potential—without losing a substantial number of customers.[95] That is, the consumer prefers the seller's brand over that of a competitor even though a price differential exists. The sources of this preference within an industry are manifold. They include: physical product differences in both quality and design, buyer ignorance which leads to reliance on seller or product reputation, persuasive sales promotion activities, and the prestige motif accompanying conspicuous consumption goods.[96] All of these sources seem to be operative to a certain degree in the automobile industry.[97] However, a special contribution is made by the retail sector of the industry: "A final important basis of product differentiation in the automobile industry is found in the nationwide systems of retail distributors and connected service garages which the established sellers control."[98]

The History of the Automobile Retail Distribution System

The early automobile industry was characterized by tremendous growth and the unusually rapid turnover of manufacturers. Between 1910 and 1921, ninety-six entrances and seventy-seven exits took place, culminating in an all-time record of eighty-eight producers.[99] Over this twelve year period, the industry failure rate was 8.5 percent.[100] This rate was considerably higher than the 0.4 to 1.1 percent rate experienced in other manufacturing, trading and commercial pursuits.[101] One explanation for this phenomenon was the extremely fragile capital basis of most manufacturers. Commercial bankers viewed the young industry with distrust and were more than reluctant to make loans for such extravagant endeavors. The undercapitalization of virtually the whole industry[102] necessitated that the producers not tie up money in

95. Entry barriers are obstacles for prospective competitors as well as aggravations for existing small competitors. Product differentiation often stabilizes market shares. This in turn supports the stability of oligopolistic market structures as well as entry forestalling effects.

96. For details see BAIN, INDUSTRIAL ORGANIZATION, *supra* note 11, at 226.

97. *Id.* at 228.

98. *Id.* at 242.

99. EPSTEIN, *supra* note 2, at 176, chart 28; SELTZER, *supra* note 2, at 65, table 5.

100. *See* EPSTEIN, *supra* note 2, at 177.

101. *Id.*

102. Ford was officially capitalized with 100,000 dollars, but no more than 28,000

inventory. They demanded payment in full in delivery. No general distribution pattern had emerged. The producers experimented with every distribution device that met their basic needs.[103] The demand situation was such that consumers were willing to pay considerable cash deposits, sometimes even the full price, upon placing their orders.[104] The distributors, often endowed with exclusive selling rights in huge territories,[105] passed these payments to the manufacturer who shipped cars immediately upon production. Later on, when some kind of orderly agency distribution device evolved, manufacturers required their dealers and distributors[106] to make considerable cash deposits which guaranteed the faithful performance under the terms of the agreement.[107] Performance deposits often financed half of a full year's production.[108] In the early 1920s the automobile retail level evolved from a ready cash market for undercapitalized manufacturers to an elaborately cultivated and thoroughly controlled device. The retail level became part of the manufacturers' struggle for optimal market penetration. Improved production techniques coupled with increased investments rapidly expanded manufacturing capacities. Capacities finally exceeded effective consumer demand.[109] Big volume sales became crucial for the efficient use of the plant capacities. To induce such sales, the manufacturers initiated more rapid model changes which were aimed at increasing the frequency of new car purchases—the planned obsolescence strategy. This development of replacement demand resulted in mounting used car inventories. In order to meet manufacturer-imposed new car quotas, dealers began making unrealistic trade-in allowances which severely threatened their profitability.[110] The proposition that the more cars the factory delivered the more profit the dealer earned was no longer true.

The manufacturers answered growing dealer dissatisfaction in a different manner, but the basic aims were the same. A shift to a direct

dollars were ever paid into the treasury of the company. SELTZER, *supra* note 2, at 88 n.5. Hudson Company started with less than 15,000 dollars. KENNEDY, *supra* note 2, at 68.

103. HEWITT, AUTOMOBILE FRANCHISE AGREEMENTS 19 (Indiana University School of Business Study No. 39, 1956) [hereinafter cited as HEWITT].

104. *Id.* at 15.

105. *Id.* at 21 n.38, reporting individual distributors with territories such as the New England states and southern California.

106. Distributors were responsible for the cultivation of their exclusive territories by a network of dealers.

107. HEWITT, *supra* note 103, at 16; EPSTEIN, *supra* note 2, at 139-40.

108. SELTZER, *supra* note 2, at 21.

109. HEWITT, *supra* note 103, at 62; SELTZER, *supra* note 2, at 59.

110. Dealers lost over 40 million dollars on used car trade-ins in 1923. KENNEDY, *supra* note 2, at 140.

dealer marketing approach took place, at least in the low-priced, high-volume lines. The general elimination of middlemen—distributors—was to facilitate tighter supervision, more effective volume pushing and better checks on the general dealer performance. Moreover, the manufacturers, especially the leading firms, required their dealers to drop competing brands. Thus, networks of exclusive dealers became dominant in the industry.

Only firms with a good model variety, a sound equity basis and a strong dealer network survived the Depression. The Big Three made their decisive breakthrough as the number of car producers and dealers dropped sharply.[111] The chaotic price structure on the retail level was partially responsible for the failure of many dealers of smaller producers. This price condition could not be fully stabilized by the National Industry Recovery Act of 1933[112] and its dealer code prescribing ceilings on trade-in allowances. After the demise of the NIRA in 1935, the dealers' attempts to preserve the benefit of limited price competition by self-regulation were successfully prevented by the manufacturers.[113] The development of the manufacturer-dealer relationship was summarized by the Federal Trade Commission in 1939.[114] It stressed that "supervision of dealer activities has become an integral part of the competition among manufacturers for volume of sales, as evidenced by the close check kept by manufacturers over the performance of dealers through their ten-day or other periodic reports on sales."[115] Moreover, the commission's report stated that "[t]he practice has grown up for manufacturers to insist that their dealers shall not handle competing automobiles, accessories, or repair parts made by other manufacturers; in other words, that the dealer shall give exclusive representation to one manufacturer's line."[116] The commission concluded that evidence of antitrust violation could not be determined from the language of the contracts alone. However, several contractual provisions were cited as possibly "lend[ing] themselves to illegal practices."[117] Significantly, clauses prescribing exclusive representation and territorial protection were among the cited provisions.[118]

Although several exclusiveness provisions in dealer franchise con-

111. *See* HEWITT, *supra* note 103, at 90-92.
112. Act of June 16, 1933, ch. 90, 73 Stat. 195.
113. J PALAMOUNTAIN, JR., THE POLITICS OF DISTRIBUTION 122-28 (1955).
114. FTC MOTOR VEHICLE REPORT, *supra* note 36.
115. *Id.* at 113.
116. *Id.* at 110.
117. FTC MOTOR VEHICLE REPORT, *supra* note 36, at 136.
118. *Id.*

tracts later succumbed to the side effects of judicial decisions or the disapproval of the Justice Department, franchise agreements have continued to be one-sided throughout their post-war history. However, the language of the contracts does not tell the whole story. The fact that automobile dealer profits have ranked well above the average for retail businesses induced at least one economist to conclude that manufacturers have not succeeded in fully exploiting their superior economic power and rights under the franchise agreement.[119] Consumer-dealership attachments and possible scale economies in the distribution of cars probably are responsible for this.[120] Today, the manufacturer-dealer relationship apparently is penetrated by knowledge of their mutual interdependence. Surely, the more money a dealer has invested in his enterprise the more dependent he is on his supplier. The manufacturer can exert control much easier. Still, losing valuable dealers to the network of a competitor is utterly abhorred by every manufacturer. Because of this, manufacturers generally exercise control via inducements, not through threats.[121] Still, the franchised automobile distribution system is firmly entrenched and somewhat similar to a medieval guild system.[122]

The Reasons for the Adoption of the Franchised Distribution System

Without exception, the American automobile manufacturers have chosen a restrictive franchise system of distribution. It is restrictive because it limits the number of outlets in contrast to selling cars to everybody who would place orders and pay cash for them. However, the question of why the companies continue to rely on the franchise system has not yet been answered satisfactorily. The early history of the industry might have necessitated the use of independent businessmen in the distribution process, especially for financial reasons.[123] However,

119. B. PASHIGIAN, THE DISTRIBUTION OF AUTOMOBILES, AN ECONOMIC ANALYSIS OF THE FRANCHISE SYSTEM 34-36 (1961) [hereinafter cited as PASHIGIAN].

120. *Id.*

121. *See* AUTOMOTIVE NEWS, April 10, 1972, at 1, col. 2 (Six Divisions Offer Incentives to Keep Spring Sales Strong); *Hearings, Giant Corporations, supra* note 5, at 77-88.

122. Excellent insight into the delicately balanced interdependence between a car manufacturer and his dealer network is provided by United States v. General Motors Corp., 384 U.S. 127 (1966). About a dozen Chevrolet dealers in the Los Angeles area allegedly threatened the viability of other Chevrolet franchisees by selling through discount houses. Upon demand by, and with the assistance of individual dealers and dealer associations, General Motors interfered. Within several months, the campaign to eliminate discounters and other referral outlets from commerce in new Chevrolets was a success. *See also* Marx, *Your Right to a Car Bargain,* 196 THE NATION 195 (1963).

123. See text accompanying notes 99-108 *supra.*

as control over dealers became increasingly important, the producers did not switch to an agency system.[124] Such a system would have had the intrinsic advantage of allowing full control without fear of antitrust objections.[125]

Arguably, a switch to factory-branch retailing would be prohibitively costly for every car manufacturer.[126] Indeed, the investment figures in the distribution system of the automobile industry are impressive. Kessler reports that in 1954 the investment of an average dealer amounted to $118,000. The overall investment of the then 42,000 dealers approached $5 billion.[127] While the number of domestic dealerships have shrunk to about two-thirds of the 1954 figure, the average investment per dealership has increased to approximately $163,000.[128] The net worth of General Motors' car dealers has been estimated to be in excess of 2 billion dollars.[129] Unquestionably, buying out all dealerships at one time would be financially crushing for the manufacturers. On the other hand, since the 1920s at least the Big Three have acquired sufficient capital to engage in a continuous process of establishing factory-operated outlets. For example, if General Motors had employed all the financial resources used for the Franchise Investment Plan it could have bought a good portion of existing dealerships, while also establishing new agencies. Moreover, in connection with their retailing plans, all of the Big Three have been busy buying real estate and erecting huge buildings in first-rate locations.[130] Nevertheless, none of the Big Three has ever seriously attempted to turn to the agency form of distribution as a marketing device.

It is difficult to determine whether the manufacturers regarded resources put into distribution as inefficient. More profitable markets for funds may have been found. This is not to say that the retailing of

124. See text accompanying notes 109-111 *supra.*

125. *See* United States v. General Elec. Co., 272 U.S. 476 (1926). *But see* Standard Oil Co. of California v. United States, 337 U.S. 293, 319-21 (1949) (Douglas, J., dissenting).

126. Interview with Robert Chatov, former professor of Business Administration, in Berkeley, California, in November 1971. Professor Chatov worked with the Ford Motor Company for twelve years.

127. Kessler, *Automobile Dealer Franchises: Vertical Integration by Contract,* 66 YALE L.J. 1135, 1137 (1957) [hereinafter cited as Kessler].

128. *Hearings on Unfair Competition and Discriminatory Automobile Marketing Practices Before the Special Subcomm. on Automobile Marketing Practices of the Senate Comm. on Commerce,* 90th Cong., 2d Sess., ser. 84, at 3 (1968) [hereinafter cited as *Hearings, Unfair Competition*].

129. A. SLOAN, JR., MY YEARS WITH GENERAL MOTORS 297 (1963) [hereinafter cited as SLOAN]. *See also* WHITE, *supra* note 3, at 320 n.23 (Average dealer investment in 1967 was $169,000).

130. *Hearings, Unfair Competition, supra* note 128, at 9.

cars on the whole is unprofitable. If it were, dealer turnover would be much more rapid, and there would be no waiting lists for Ford and General Motors franchises.[131] However, a financial commitment to the distribution level would be very inflexible. Once an agency system is established, there would be no real alternative other than to use it. Moreover, the present franchise system allows the manufacturers to achieve nearly perfect control over the distribution process without assuming legal responsibility. The dealers' small remainder of economic freedom causes some planning uncertainty for the manufacturers. However, the elimination of this freedom may not have been deemed to be worth the huge investment necessary to establish an agency network.

A second argument advanced for the adoption of a franchise system is that the administration of a factory-operated distribution system would tend to be rather clumsy and inflate unnecessarily the manufacturer's administrative body. Performing the wholesale functions of distribution by fully integrated units would be enough of a burden. This argument claims diseconomies of large scale in the administration of a corporation. However, such claims overlook the fact that the employment of a franchise system does not liberate the manufacturer from administrative and supervision burdens. The dealer reports, which are expected every ten to thirty days, have to be analyzed; each dealer's performance must be evaluated individually. One of the main features in the current distribution system is that the manufacturers try to forecast and to influence market developments with meticulous accuracy. The members of the automobile industry try to eliminate haphazard marketing elements.[132] Therefore, constantly revised market surveys are made regardless of the type of distribution system. Checking dealer performance, sometimes claimed to inflate administration costs, is basically as expensive as the preparation, consummation and control of an efficient agency distribution system. Nevertheless, the claims of increased administration costs have some merit. Roughly 700,000 persons are employed by the domestic car distribution system.[133] Having them as factory employees would cause a tremendous record keeping effort, not to mention difficulties in initial selection.

In addition to costs of creation and administration, a factory-owned distribution system would subject the manufacturer to new risks. When the used car trade-in became important, an element of trading

131. *See* PASHIGIAN, *supra* note 119, at 11. Ford and General Motors have never advertised directly to attract dealers. WHITE, *supra* note 3, at 148.

132. GALBRAITH, *supra* note 9, at 16.

133. *Hearings, Unfair Competition, supra* note 128, at 3.

was added to the distribution function. This was accompanied by risks and problems that the manufacturers did not want to assume. They avoided any direct to the consumer distribution plan, thus avoiding the opportunity for more exact retail price maintenance. It is this trading element rather than the necessity to supervise the performance of every single outlet that Sloan had in mind when he stated: "Organizing and supervising the necessary thousands of complex trading institutions would have been difficult for the manufacturer; trading is a knack not easy to fit into the conventional type of a managerially controlled scheme of organization."[134]

More importantly, while avoiding this risk, the franchise system provides incentive for dealer performance. Due to his enormous financial commitment, the owner of a dealership will just try harder. A branch manager, however capable he might be, has neither his income nor his investment at stake. The only penalty for his business mistakes or lack of initiative is the loss of his job.[135] Also, since the franchise holder has his resources involved, he contributes to sales promotion costs which otherwise would have to be borne by the manufacturer alone.[136] Thus, in the areas of risk,[137] performance and sales promotion, the franchise distribution system offers advantages over a factory-operated system.

Another reason for the adoption and deliberate continuation of the franchise system is the fact that most dealers are members of the community where they sell. They can develop much more personal contact with their customers than a foreign branch manager. To a certain degree, consumer attachment to a dealership is the outflow of personal relations to the owner. Even if the public sometimes does not distinguish between agencies and independent company representatives, many a customer does consider whether the head of the outlet is a community fellow or some "foreigner." By setting up its own distribution system, the manufacturer would lose "the advantage of being represented in the community by 'good old Joe Doakes, rather than a faceless corporation.' "[138] The established dealer's personal image and reputation tends to be projected on the manufacturer's image and is

134. SLOAN, *supra* note 129, at 282.

135. EPSTEIN, *supra* note 2, at 135-36.

136. The average dealer spends more than $12,000 annually for local advertising. The total advertising budget for all franchised automobile dealers in the United States is nearly $400 million. *Hearings, Unfair Competition, supra* note 128, at 3. See also AUTOMOTIVE NEWS, Aug. 7, 1972, at 1, col. 3.

137. *See* PASHIGIAN, *supra* note 119, at 97; WHITE, *supra* note 3, at 137.

138. Note, *Restricted Channels of Distribution under the Sherman Act*, 75 HARV. L. REV. 795, 806 (1962) [hereinafter cited as *Restricted Channels*].

subject to much more social check than a branch manager who neither personally nor geographicaly identifies with the community. This argument might be more convincing in rural areas, but it certainly holds generally.

Two closely interlinked reasons may also bear a relation to the manufacturers' decision to maintain a franchise distribution system. Independent dealers are obligated to buy—and sell—certain quotas. These dealers furnish a ready cash market. They generally pay the manufactuer's wholesale price without regard to current market fluctuations. Price conditions at the retail level do not bother the manufacturer unless they tend to have a disastrous long-run effect on the whole distribution system—for example, overall losses to dealers due to unrealistic demand/supply/price determinations. Therefore, dealers can be forced to absorb at least part of the costs resulting from overproduction or styling errors.[139] These costs would have to be borne by the manufacturer alone in any factory-operated retailing system.

Reasons for the Adoption of a Restrictive Franchise System

The preceding discussion has explained why the car manufacturers favor a franchise retail system. What remains is to ascertain why the number of retail outlets has been limited by the manufacturers. If the manufacturers responded to every order of an individual who is willing to pay cash for an automobile, the distribution process would become a horrible mess. The administration of such a system would be unduly costly. Delivery costs would be inflated. Moreover, the companies would have to perform the dealers' duty of car preparation at the factory. Large amounts of money would be necessary to stock the cars, whether near the factories or in several large wholesale outlets. A network of strategically located retailers alleviates all these burdens.

This, however, does not answer the question why all applications for the establishment of full-dressed dealerships are not positively considered. There is certainly a big difference between the number of those who would order a car for their private use and those who seriously want to go into the car retail business. Nevertheless, economies of scale at the distribution level mitigate against a manufacturer granting too many franchises. When two dealers operate in an area and economies of scale cannot be exhausted by either, distribution costs may be increased. This may lead to the eventual loss of at least one dealer, a possible disruption in the selling process and a breakdown

139. Styling errors are more detrimental for a manufacturer of fewer models. *See* PASHIGIAN, *supra* note 119, at 97.

of consumer-dealership attachments. Additionally, limiting the number of dealers is likely to channel retail competition into nonprice forms. Since the importance of dealer personality probably will diminish in a price emphasizing market, the current franchise system preserves consumer-dealer attachment. This unquestionably benefits the manufacturer.[140]

Furthermore, unlimited entry into the retail network would weaken the manufacturer's ability to protect existing dealers from losses resulting from unexpected shifts in demand.[141] In turn, the profit basis for dealers would be weaker. This result would tend to discourage high grade and financially strong persons from entering the automobile industry in the retail function. By having fewer, financially stronger dealers, the manufacturer can better induce or require more intensive dealer investment in buildings, inventories and service facilities. The general appearance of a dealership has always been associated with prestige of the manufacturer. Consumer brand attachment is easier to establish through a certain outlet "fancification." Moreover, continuous dealer investments assure the manufacturer that the dealer will be able to render adequate service.

In addition to protecting the dealer's profitability and encouraging investment, the restrictive franchise system serves the manufacturer in other ways. As long as a dealer's profit basis is sufficient, he will have little reason to handle another manufacturer's cars. His sales efforts will be concentrated on one brand. In all likelihood, this factual exclusiveness facilitates the manufacturer's efforts to gain and maintain a relatively closed market for its parts and accessories. While the manufacturer in its own interest has to allow its dealers a good profit, it can avoid its dealers' losing their aggressiveness in cultivating the market. Dealers who do not perform satisfactorily can be eliminated by cancellation or nonrenewal of their franchise agreements.

Finally, the limited and relative stable group of dealers operate in a comparatively protected market.[142] They can forward more accurate estimates of future demand than dealers who are in and out of market. The more exact these estimates, the easier is optimal long-run production and marketing planning. This in turn assures the dealers that they will not face distressing retail market conditions. If the planning is incorrect, the manufacturer can expect that fluctuations in final demand will be met by changes in dealer inventories rather than its rate

140. *Id.* at 37-44.
141. *Id.* at 39.
142. HEWITT, *supra* note 103, at 55.

of production. Thus, even without full forward integration, the automobile manufacturers have been able to achieve almost perfect economic control over the distribution sector without being exposed to the legal responsibilities and administrative burdens intrinsic to an agency system.

The advantages for the dealers in the automobile franchise system have almost exhaustively been enumerated in the foregoing discussion. Even in the absence of territorial securities, the restrictive franchise system gives each dealer a certain guarantee that under normal circumstances he will earn a fair profit and be able to amortize his investment. "If he is a good man who knows his business, he . . . eventually can average at least 25% return on his investment."[143] The dealers can count on a steady supply and do not have to fight for a profitable supply source. Since the nature of the dealer-manufacturer relationships fosters mutual dependence, each dealer can expect his manufacturer to assist him in effective merchandising. To be sure, these advantages do not spring from the manufacturer's sheer benevolence but only reflect the naked self-interest of the car producer. The gain of increased business prestige "through affiliation with a large organization, frequently of national extension"[144] has to be acquired at the expense of much of the dealer's business independence.

The alleged advantages to the public of the restrictive franchise system are many. They include service by trained mechanics, the overall availability of repair parts, an efficient distribution system, considerable ease in the disposal of the old car[145] and financial soundness of each dealer. This financial soundness increases the likelihood of his remaining in business. The customer is protected from being cheated because fraudulent practices are not conducive to maintaining the dealer's reputation. Furthermore, since dealers serve as a kind of price bumper in cases of overproduction and styling errors, the public may not be charged with the price of these manufacturing mistakes. Of course, the question remains whether these advantages can be achieved, or even enlarged, by alternative methods of distribution which may prove less costly—in the broadest possible meaning—for the consumer.

Automobile Retailing and Product Differentiation

The automobile producers apparently believe that consumer brand

143. S. MACAULAY, LAW AND THE BALANCE OF POWER: THE AUTOMOBILE MANUFACTURERS AND THEIR DEALERS 170 n.790 (1966) *quoting* Boyd, former Chrysler official [hereinafter cited as MACAULAY]. One is tempted to wonder whether Mr. Boyd is aware of the difference between dealer discounts and actual profits.

144. Kessler, *supra* note 127, at 1136.

145. M. BURY, THE AUTOMOBILE DEALER 1 (1958).

attachment is achieved at the lowest cost through the existing distribution system. Consumer brand attachment is nothing more than product differentiation. Each manufacturer's dealers substantially differentiate the delivered product from those of competitors. This is accomplished by two dealer functions: personal sales promotion and specialized maintenance and repair service.[146] Moreover, high nationwide dealer density provides the Big Three with advantages of market coverage and penetration, and the consumer views this density as providing easy access to service and repair parts regionally and nationally. Additionally, the Big Three have developed financially strong and efficient dealers. Consequently, their dealers enjoy better locations and attractive sales and service facilities. These, in turn, have a significant sales promotion effect and enhance the creation of consumer attachment. This cycle has led commentators to rank the use of large elaborate distribution and service facilities among the most important sources of product differentiation in the automobile industry:

> By saturating an area with dealers handling their own respective products exclusively, the three or four sellers with the best-known brands can effectively deny their smaller existing and potential competitors access to the best sites and most efficient retailers . . . raising the per-unit sales and distribution costs of those . . . competitors while entrenching still further their own "brand" names in the minds of local consumers through the "advertising effect" of the elaborate local dealer establishments, organizations that control many thousands of square miles of gleaming floor space and flashing neon signs. In other words, these exclusive dealerships, or, as they are sometimes called, these "vertical-integrations-by-contract," are themselves a form of "advertising," . . . thus forcing any existing and would-be competitor to [develop] its own separate chain of dealer outlets, establishments that will . . . be placed on less desirable sites and manned by less experienced operators, thus raising that competitor's per-unit costs and, by keeping its products on the "back shelves," so to speak, lower its acceptability in the eyes of consumers and thus the per-unit *price* it is able to command.[147]

The functioning of the distribution system contributes to the creation and maintenance of an automobile's reputation. It is a kind of advertisement. Even if product quality is inferior, superior service may compensate, thus preserving an already established reputation. The more perfect the interplay between product, selling activities and service, the higher is the probability that the product will be nonstandardized in the eye of the consumer. This heightens the differentiation

146. BAIN, INDUSTRIAL ORGANIZATION, *supra* note 11, at 242; Lanzillotti, *supra* note 73, at 330.

147. Mueller, *supra* note 80, at 80-81.

gap, and price becomes less of a determining factor for customer loyalty.

Despite the distribution system's operation as a source of product differentiation, it cannot be condemned without further analysis. One commentator has warned:

> The mere departure from the purely competitive model does not alone signify that condemnation is appropriate. Lower consumer substitutability often results from real differences among products and from the peculiar skills or attributes of particular firms. In these instances, the price effects of product differentiation are often offset by the social gains resulting from the existence of product variety.[148]

Business policies which promote product differentiation are often an important form of interbrand competition. Unfortunately, in the automobile industry, "real differences among products" in the same price range are negligible; "peculiar skills . . . of particular firms" are not obvious. Apparently, the warning is not applicable because the price and entry barrier effects are not offset by such social gains.

Yet, despite its contribution to product differentiation, the current distribution system need not be eliminated. Interestingly, small competitors and newcomers attempt to find "exclusive" dealers wherever possible. They are not compelled by some lemming-like instinct to follow the Big Three. Rather, great benefits can be derived by *all* competitors from an orderly and controlled system of distribution. When the current system emerged,[149] it was accepted by all competitors as superior to haphazard marketing methods. The public received a reasonably reliable means of transportation only after there were outlets for replacement parts and persons trained in repair. Moreover, as manufacturers guaranteed free repair work immediately after purchase, this warranty had to be fulfilled by trained mechanics. The distribution of cars and parts would have proven less efficient and more costly if the manufacturers had not concentrated these tasks in the hands of a limited number of selected dealers. These dealers were responsible for the maintenance of adequate service and repair facilities, including an inventory of replacement parts.

No alternative method of automobile distribution has been attempted since the emergence of the franchise system. If any other conceivable method was less expensive for the manufacturer and equally efficient in terms of consumer satsifaction, one of the many

148. Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 HARV. L. REV. 1419, 1424 (1968) [hereinafter cited as Comanor].

149. See text accompanying notes 110-111 *supra*.

foreign newcomers to the American car market surely would have tried an alternative marketing method. Probably no other method would guarantee the same product differentiation effect. However, if an alternative was less costly for the entrant, he could lower his price; or if price elasticity in the automobile market did not make price cuts worthwhile, he could offset product differentiation disadvantages arising from his distribution method by spending more for advertising.

Seemingly, alternative methods of distribution are not considered to be desirable by those who are disadvantaged—foreign and small domestic manufacturers—by the present system. This is demonstrated by their uniform adoption of the franchise system. Therefore, a radical industry-wide reorganization of the distribution pattern should be enforced only if the current pattern deprives the public of otherwise obtainable benefits. Since automobile manufacturers are likely to favor the franchise system even under the conditions of a restructured industry, it is senseless to break up existing dealer networks and order all car manufacturers to start over again. In addition to short-run disadvantages to milions of car owners, competition on the production level would not benefit if new restrictive retail patterns emerged before new entries occurred. Furthermore, the entry barriers created by scale economies and capital requirements alone are high enough to scare potential competitors away.[150] Because of these barriers, the additional obstacles raised by the distribution system do not play a crucial part in a potential entrant's consideration. In no case do these additional barriers seem important enough to risk a disruption of service to the consumer. New distribution devices may *gradually* emerge due to legal objections against territorial restrictions or against the manufacturer's' control over the repair parts market. This evolution could be very beneficial. However, to attack the automobile franchise system merely for its contribution to product differentiation would be ill-advised. A distribution device which has no product differentiation effects, which is adequately efficient in terms of consumer satisfaction and which is equally accessible to and beneficial for both large and small competitors in the automobile industry has yet to be invented.

In view of the foregoing, the problem of the distribution system's contribution to product differentiation necessarily must be reformulated. Without sufficient coverage of the retail and service markets, an automobile producer is unlikely to sell the annual volume necessary to reach minimum optimal scales of production. This underrepresented producer will be unable financially to keep up with the Big Three in

150. See text accompanying notes 56-87 *supra*.

every competitive respect. This is amply supported by fact. For example, Kaiser's failure was due partly to a lack of a reliable dealer network. Dealer organization figured prominently in the merger discussions of the independents.[151] Also American Motors' various fortunes in the 1950s clearly were reflected in its changing dealer strength.[152] Furthermore, Studebaker-Packard's rapid descent in the early Sixties was foreshadowed by a constant loss of dealers. Finally after facing deficits in 1958 and 1959 and very meager profits in the two following years,[153] Chrysler emphasized the fortification of its shrinking dealer body. This emphasis was accompanied by intensive use of the Dealer Enterprise Plan, which was designed to assist in the establishment of new retail outlets. Despite these factors and the dismal experience of producers such as Kaiser and Studebaker-Packard, small competitors apparently still benefit from employing the franchise system. Nevertheless, they face many difficult obstacles. The Big Three are represented by the financially strong and experienced dealers with first-rate facilities in strategically important locations. While a newcomer's dealers certainly could render satisfactory service and make fair deals, reputation and a buyer-dealership allegiance would be established only after some time. Even then, this allegiance would be strained because the trade-in value of a newcomer's or small competitor's product is generally low.[154] This strain would occur irrespective of the product's quality and competitive attributes. The buyer is influenced also by "orphan car" considerations.[155] Thus, any discussion of the Big Three's product differentiation advantages resulting from their allegedly superior distribution system seemingly reduces to two nuclei: time and size on the production level.

Reputation, whether built up by superior quality and design or by consumer ignorance, is the result of these nuclei. Over time, the Big Three allegedly have absorbed the best possible dealer locations, thus enhancing sales promotion. This process can be seen as the final stage in the development of product differentiation advantages, which is evidenced by the relatively slow dealer turnover.[156] Consequently, Big Three dealers remain in business longer, which in turn enriches buyer

151. At the beginning of 1950, the independents had issued the following number of franchises: Hudson, 2128; Nash, 1178; Packard, 1363; and Studebaker, 2270. EDWARDS, DYNAMICS, *supra* note 3, at 227.

152. *See id.* at 68-69.

153. See note 51 *supra.*

154. BAIN, INDUSTRIAL ORGANIZATION, *supra* note 11, at 244; BAIN, BARRIERS, *supra* note 21, at 305-6; PASHIGIAN, *supra* note 119, at 7-8.

155. WEISS, *supra* note 44, at 346.

156. *See* PASHIGIAN, *supra* note 119, at 22-24.

confidence in the dependability of *his* dealer. These factors accrue only by the passage of time. A newcomer cannot match any of these advantages instantaneously by trying to build up its own dealer network. However, serious suggestions for diluting the Big Three's time advantage are not conceivable. Placing the Big Three on equal footing with newcomers or small competitors by ordering the termination of all existing dealerships or abandonment of facilities in strategic locations, is unrealistic.[157] Even though such action would dilute some of the Big Three's time advantage, their size advantage cannot be matched by any competitor. The huge output of cars necessary to nourish a dense dealer network is unobtainable.

If bigness is indeed the main source of product differentiation advantages, the source—not the symptoms—should be attacked. Even if the distribution system has contributed to the Big Three's size and market power to some degree,[158] this is not yet a sufficient basis for restructuring it. If the conduct of the existing manufacturers does not contribute *unnecessarily* to a natural entry-forestalling effect which is attributable to the indispensable existence of dealer networks, a basis for an attack against distribution-caused product differentiation would be difficult to find. Rather, the product differentiation effects of the distribution system must be formulated in a different light. This requires consideration of whether the practices found in managing automobile distribution *artificially* increase the product differentiation entry barriers which already exist because of reputation, conspicuous consumption motives and sales promotion. Artificially means a contribution not attributable solely to the size—output volume—of the Big Three and time. Such an analysis must determine whether and to what degree the Big Three have prevented their competitors access to their dealers' experience and financial capacity[159] and whether the Big Three have endowed their dealers with *undue* market power on the retail level thereby substantially reducing intrabrand competition.[160]

Dealer Efficiency Regulation, the Location Clause and Section 1 of the Sherman Act

Since 1951, the number of American passenger car retailers has

157. The suggestion would destroy only dealer allegiance. Product attachment would still create a superior starting position for every new Big Three dealer.

158. *See* BAIN, BARRIERS, *supra* note 21, at 302.

159. *See id.* at 301; Mueller, *supra* note 80, at 90.

160. Another issue is whether the manufacturers have forced their dealers to purchase parts and accessories exclusively from the respective manufacturers. However, this issue is beyond the scope of this article and will not be discussed.

steadily declined.[161] Over the same period new car registration has increased from 6,326,438[162] to 8,263,436.[163] The interrelation between these factors is expressed by a near doubling of the number of automobiles sold per outlet.[164] This loss of dealerships is not the result of termination for insufficient representation. The principal reason for termination is death of the dealership's owner.[165] While this explains dealer turnover, it does not explain the failure to substitute successors in the same or an adjacent location. One possible explanation for the shrinking number of dealerships could be a tendency towards intercorporate dualing. Intercorporate dealerships are franchised by at least two domestic manufacturers. However, the number of intercorporate dealerships declined at approximately the same rate as the num-

161. The number of retail outlets since 1951 is as follows:

Source: AUTOMOTIVE NEWS, Jan. 31, 1972, at 1 and July 31, 1972, at 1

Date (Jan. 1)	No. of retail outlets	Date (Jan. 1)	No. of retail outlets
1951	47,543	1962	31,331
1952	46,014	1963	30,853
1953	45,191	1964	30,827
1954	41,910	1965	30,691
1955	40,374	1966	30,278
1956	41,018	1967	28,422
1957	37,982	1968	27,784
1958	37,188	1969	27,486
1959	35,077	1970	27,071
1960	33,658	1971	26,126
1961	32,482	1972	25,126
		1972	25,621
		July 1, 1972	25,530

162. 1970 AUTOMOTIVE NEWS ALMANAC 29.

163. AUTOMOTIVE NEWS Feb. 21, 1972, at 29.

164. New car sales per outlet since 1955 are as follows:

Source: AUTOMOTIVE NEWS, Feb. 28, 1972, at 1.

Year	Americ. Mot.	Chrysler	Ford	G.M.	Studeb.	All U.S. Industry
1955	49	129	225	215	47	175
1957	56	130	194	169	30	154
1959	127	97	199	169	53	158
1961	125	104	208	193	34	172
1963	139	163	243	283	33	233
1965	115	213	318	351	8	299
1967	100	212	258	321		270
1969	104	233	332	351		307
1971	114	240	343	361		320

165. From 1965 to June 1969, 975 General Motors' dealers were terminated: 831 because of death, 32 for inadequate sales performance, 15 for failure to provide adequate service, 13 for insolvency or bankruptcy, 38 because the dealer ceased business operations, and 46 for various other reasons. *Hearings Before the Subcomm. on Urban and Rural Economic Development of the Select Senate Comm. on Small Business: The Impact of Franchising on Small Business,* 91st Cong., 2d Sess., Part 2, at 817 (1970) [hereinafter cited as *Hearings, Small Business Franchising*]. For Chrysler's experience, see *id.* at 860.

ber of dealerships.[166] Therefore, the foregoing would indicate a trend towards fewer and larger dealerships.[167]

This trend towards larger dealerships could be manifested in a growing number of intracorporate retailers.[168] The gap left by a terminated dealer is filled by one of the manufacturer's established dealerships in the same vicinity. In the past, this dealer handled a different line for the same manufacturer. Thus, an intracorporate dealership is created. The members of the Big Three[169] increasingly have created these dealerships over the last four years.[170] Seemingly, this is not explained only by recession periods in general or strike situations encountered by a single manufacturer. Remarkably, the increase of General Motors' intracorporate multiples was slighter during the strike year of 1970 than in 1969 and 1971. Although this three year trend will not necessarily continue, it certainly casts doubt on Pashigian's observation that "dual dealerships have been discouraged as long-run policy."[171] Not a single line is distributed solely by intracorporate exclusive dealerships.[172] It is, therefore, questionable "to consider the use of multi-line dealers as a short-run device for cushioning the effects of a sales decline."[173]

If the number of franchises granted by the Big Three had remained constant, the dealership decline could be explained fully by intracorporate dualing. However, the decline in franchises granted over

166. Intercorporate duals declined as follows:

Year (Jan. 1)	Dealerships	Intercorporates	Percentage of Intercorp.
1969	27,486	655	2.38
1970	27,071	725	2.67
1971	26,126	755	2.88
1972	25,621	680	2.65
July 1 1972	25,530	670	2.62

These data were computed from the following sources: AUTOMOTIVE NEWS, Jan. 31, 1972, at 81; 1970 AUTOMOTIVE NEWS ALMANAC 72.

167. AUTOMOTIVE NEWS, Jan. 31, 1972, at 81.

168. An intracorporate retailer is a dealer who retails at least two brands of one manufacturer.

169. American Motors sells only one brand.

170. The annual percentages of intracorporate dealerships are as follows:

Company	1969	1970	1971	1972
Chrysler	58.4%	59.5%	61.4%	62.8%
Ford	35.3%	37.1%	38.7%	40.5%
G.M.	38.2%	39.1%	39.3%	40.0%

These data were compiled from the following sources: AUTOMOTIVE NEWS, Jan. 31, 1972, at 81; 1970 AUTOMOTIVE NEWS ALMANAC 72.

171. PASHIGIAN, *supra* note 119, at 117.

172. An "intracorporate exclusive dealer" is a dealer who is not dualed in either an intercorporate or intracorporate sense.

173. *Id.* at 123.

the last four years[174] is less sharp than the decline in dealerships.[175] Therefore, neither the loss of dealerships nor the considerable increase of cars sold per outlet is fully explained by intercorporate or intracorporate dualing.

Dealer Efficiency Regulation

Two other interlinked factors share in these developments. Population has shifted noticeably from rural to urban areas. Accordingly, the basis for a sufficint sales volume of a dealership in a rural area declines thereby endangering the profitability of all dealerships within the area through overrepresentation of the brand. In these cases, the manufacturer simply will not substitute new dealers for those who quit or are terminated.

The second factor is that the average dealership is still far from achieving a minimum optimal scale. In Pashigian's extensive study of the relationship between dealership size and profitability,[176] he ascertained that the per unit costs of dealerships rise noticeably if sales decline below 600 units annually.[177] "However, [the data] suggest that further economies appear to be modest once a firm has reached the asset size of about $500,000 which would be equivalent to a new car volume of about 600 new units annually. Further economies may be experienced as the size of firm increases, but they do not appear to be significant."[178] Pashigian estimated that according to two different per unit cost indices, the costs per unit for retail sales of 300 units annually were 115 or 130 percent of the standard costs for 600 or 800 units respectively.[179] If the price-demand elasticity for new cars was negligible and all dealers in all market segments encountered the same diseconomies of scale, manufacturers would not have to be concerned

174. Total franchises granted by the Big Three:

Company	1969	1970	1971	1972
Chrysler	12,247	12,100	10,177	10,065
Ford	9,787	9,849	9,781	9,864
G.M.	17,870	17,740	17,410	17,400
Total	39,904	39,689	37,368	37,329
Totals adjusted for Imperial franchises	38,440	38,219	37,368	37,329

The 1971 decline of Chrysler dealers was in large part due to the expiration of 1470 Imperial franchies. These data were compiled from the following sources: AUTOMOTIVE NEWS., Jan. 31, 1972, at 81; 1970 AUTOMOTIVE NEWS ALMANAC 72.

175. *Compare* note 174 *supra with* note 161 *supra.*

176. *See* PASHIGIAN, *supra* note 119, at 196-216.

177. *Id.* at 223. *But see* WHITE, *supra* note 3, at 49 (in rural areas, the minimum efficient scale may be considerably lower than 600 units per year).

178. PASHIGIAN, *supra* note 119, at 210.

179. *Id.* at 223.

with scale economies at the retail level. However, a weak price-demand elasticity does exist. Since increased retail costs result in increased retail prices, overall sales volume expansion is impeded. Moreover, actual differences in dealer costs hamper the manufacturer in interbrand competition.

Each member of the Big Three reacts identically to shifting populations and retail scale economies. They attempt to strengthen their dealers by increasing the number of intracorporate duals and by meticulously determining the sales capacity in each market segment. The continuous analysis of detailed dealer sales reports and concomitant adjustments to market surveys lead to the development of certain sales objectives for each dealership. However, these analyses and adjustments also lead to dealer efficiency regulation based on the number of dealers which an area can bear while maintaining profitability.[180]

This substitutes regulation by manufacturers for that which would result through the market itself. Such a result is most objectionable in rural areas where dealers are assigned large areas of primary responsibility.[181] Where the number of outlets is limited in the first place, any further limitation restricts intrabrand competition among the dealers of each company. Additionally, vigorous sales efforts in interbrand competition are reduced to nonprice competition, bringing the oligopolistic effect to the retail level. Seemingly, this is at odds with the manufacturers' basic aim of inducing their dealers to engage in fervent interbrand competition.

However, especially in sparsely propulated rural areas, the decline of interbrand competition may well be for the manufacturers the lesser of two evils. A lack of sales volume and the resulting profitability loss might necessitate intercorporate dualing. Such a dealer reaction usually is watched with suspicious eyes by the sovereigns in Detroit. The intercorporate dealer may be deflected from devoting his full efforts to his primary manufacturer. Accordingly, when market surveys deem it necessary, terminated dealers are not replaced so that problems associated with a superabundance of dealerships are avoided. Intracorporate dualing is encouraged to provide each dealer with a sufficient sales potential.

Both the small manufacturer and the public are victims of this development in rural areas. The Big Three are not required to support American Motors or any small foreign competitor. However, dealer efficiency regulation shelters Big Three dealers from the economic ne-

180. *See Restricted Channels, supra* note 138, at 803 & n.35.

181. See text accompanying notes 234-47 *infra.*

cesity of acquiring another manufacturer's franchise. This tends to enlarge the operation requirements for dealerships of the independents, making market penetration by small competitors and potential newcomers more difficult especially in sparsely populated areas. While a thirty percent decline in the number of General Motors dealerships would not affect its market penetration seriously, a small manufacturer lacking the opportunity for intracorporate dualing would suffer considerably from a similar loss of its dealer body.[182] In addition to its deleterious impact on market penetration by small competitors, dealers efficiency regulation affects the public adversely. This effect sometimes is expressed as a local service monopoly. However, there is more to it.

The Navajo Story

The several facets of public interest involved in efficiency regulation are illustrated by the Navajo Indians' attempts to obtain a General Motors dealership.[183] The Navajo reservation in Arizona covers an area of 24,000 square miles. This is approximately five times larger than the State of Connecticut. Yet no sales outlet or authorized service garage of any automobile manufactuer exists within this territory. The communities located near the boundaries of the reservation are served by dealerships and service garages available at distances from 30 to 75 miles. However residents of the central part of the reservation must travel from 70 to 190 miles. About 2,000 motor vehicles, mostly pickup trucks, are owned by the reservation's 125,000 inhabitants.[184] Car owners from Chinle, roughly in the center of the reservation, must traverse the following distances for service: 100 miles to Gallup, New Mexico, 120 miles to Holbrook, Arizona, 150 miles to

182. From January 1, 1960 to January 1, 1972, General Motors dealerships dropped from 14,845 to 12,125 (18.3 percent); American Motors dealer body shrunk from 2,977 to 2,025 (32 percent). *See* 1970 AUTOMOTIVE NEWS ALMANAC 7; AUTOMOTIVE NEWS, Jan. 31, 1972, at 81. Over the same period, General Motors dealers increased their sales from 169 to 361 units per outlet; American Motors dealers' sales declined from 127 to 114 units per outlet. *See* AUTOMOTIVE NEWS, Feb. 28, 1972, at 1. See also note 164 *supra*.

183. The background for this section is correspondence between Professor Lawrence A. Sullivan, University of California, Berkeley, School of Law, and Robert Hilgendorf. Further material was supplied in interviews with Robert Hilgendorf at Chinle, Arizona, Mar. 28 & 29, 1972.

184. These motor vehicles are indispensable to the inhabitants of the reservation. For example, wood or household fuel must be transported many miles by families. Few families have wells for water. Water must be hauled a minimum of several miles for domestic use. Travel to stores for food and other necessaries often involves distances of 100 miles.

Winslow, Arizona, and Farmington, New Mexico, and 200 miles to Flagstaff, Arizona. Each of the first four communities has only one dealership for each of the Big Three. Trained mechanics do not exist on the Navojo reservation. Thus, each dealership entertains a service monopoly to some extent. Even assuming that these monopolies are not exploited in the form of inferior work and unreasonable service charges, the enormous distances between Navojo communities and the service garages burden all reservation car owners. Moreover, customer choices in new car purchases are limited. Intrabrand competition virtually does not exist. A buyer's shopping around is limited to a comparison of offers made by the Big Three dealers in one of the dealership communities unless the customer undertakes the task of commuting between Flagstaff, Winslow (58 miles) Holbrook (another 34 miles), Gallup (another 89 miles), and Farmington (another 119 miles). Also, the existence of only three car dealers in a location representing a segregable geographical market is most conducive to the establishment of price floors which negate the buyer's shopping advantages. This can occur in the absence of any collusion. Finally, the absence of dealerships within a radius of 100 miles has the practical effect of weakening warranty coverage for Navajo customers.

In order to rectify this situation, several members from the Chinle community formed the Tsegi Motor Company and tried to obtain a General Motors franchise.[185] The dealership was to be a community venture and run on a nonprofit basis. The land and all labor necessary to build the facilities were to be donated. This proposal met General Motors' objections. Under its Motors Holding Plan,[186] a twenty-five percent self-investment is required. This investment could not be provided by any single member or group in the community. Moreover, General Motors rejected nonprofit operation because it deprived the operators of a profit maximizing incentive and would endanger the project in periods when losses would occur. This, of course was accompanied by the unspoken fear that General Motors' investment in the dealership might not be recoverable. When the Navjos suggested that they could obtain sufficient funds, the manufacturers raised objections based on dealer efficiency considerations:

[D]ealership locations for any community or metropolitan area

185. After one year of being shuffled from one General Motors official to another, Tsegi's legal representative gave up. However, the matter is currently being pursued, even though it is far from final agreement.

186. Under its Motor Holding Franchise Investment Plan, the General Motors-owned Motor Holding Division loans up to seventy-five percent of the capital required for new General Motors' dealers.

> [are selected] with certain fundamental objectives in mind. Examples would be, an attempt to place the dealer in a position to render convenient service to owners and prospective customers within the area and help assure a reasonable profit potential for the dealership over the business cycle. Many factors are considered, such as population and population trends, historical and anticipated sales, availability of land and facilities, economic conditions in the local vicinity and, importantly, present dealership representation as well as an analysis of car registrations over a period of time.
>
> Survey teams employed by each Division continually review and collect statistical and economic information in connection with each metropolitan area. Each existing or potential dealership is studied carefully. This means that as areas experience shifts in population and varying degrees of growth, and as highways and population patterns shift, corresponding changes in number and location of dealerships eventually occur.[187]

This summary represents objective prerequisites which must be met before any of the Big Three grants a new franchise. In addition, subjective considerations—sometimes called the "three Cs," cash, character and capacity—are included.

Even though General Motors ascertained that the Chinle area conceivably could sustain and support a small Chevrolet dealership,[188] the franchise application was rejected. This rejection was based on efficiency regulation considerations including "the equities of all current existing dealers . . . as well as the equities of the total Navojo people."[189] Tsegi Motors was advised by the Chevrolet zone manager that the Chinle area lies within the area of primary responsibility of Gallup and Holbrook. These two General Motors dealers claimed that the loss of the reservation sales potential would prove fatal to their economic existence. Presently, these two dealerships are still very much alive, and the Navjo people are still waiting for convenient service.[190]

This description is not to deny that entry barriers due to scale economies exist on the distribution level. However, the Chinle dealership was viable. The question of whether its existence would be more valuable for the public than the survival of the Gallup and Holbrook

187. Letter from R. B. Harris, Dealer Development General Motors Marketing Staff, to Robert Hilgendorf, Aug. 27, 1970.

188. On the basis of a market survey, twenty new cars and sixty-eight pickup trucks could be expected to be sold annually. This is about fifteen vehicles above the minimum requirement for the profitability of a dealership.

189. Letter from G. M. Molloy, Manager, Dealer Development, to Robert Hilgendorf, Nov. 17, 1970.

190. Neither Ford nor Chrysler have been approached by Tsegi Motors or other similar Navajo corporations.

dealerships will not be answered. Yet if the survival of these two dealers really depended on the additional forty-four cars sold annually by each to Navajo customers, General Motors could use its superior capital position and temporarily loan funds to these dealers thereby tiding them over incidental losses due to the new competition.[191] If the Gallup and Holbrook dealers' bleak financial outlook resulted from the potential loss of service and parts business, it could be concluded that the local service monopoly has been exploited up to now. General Motors' rejection of Tsegi's application invites speculation that it did not expect to gain any greater market penetration. This speculation arises for two reasons. First, most of the Navajo people are attached to General Motors cars and pickups anyway. Secondly, any possible gain would be outweighed by competitive disadvantages suffered by the Gallup and Holbrook dealers. Ford and Chrysler dealers might develop a superior profitability basis due to their higher sales volume.

Dealer Efficiency Regulation and Sherman Section 1

The experience of Tsegi Motors illustrates the effects of dealer efficiency regulation on the consumer. The legal analysis of this experience demonstrates the antitrust aspects of the current automobile distribution system. Undoubtedly, a system of selective franchising and its concomitant efficiency regulation restrains trade. Not everybody can deal with new General Motors cars; these cars are available to the public only through a limited number of outlets. Moreover, warranty coverage requires that service be performed by authorized service garages; these service facilities are limited. Finally, although independent service garages exist, the dealers' garages enjoy a decided advantage in mechanical training and parts inventories. These advantages result from membership in the franchised dealer body. Again, General Motors has deliberately channeled, and thereby limited, the availability of repair parts and qualified service. However, restraints of trade are intrinsic in every contract. Section 1 of the Sherman Act in its judicial interpretation[192] only outlaws *unreasonable* restraints of trade.

Combination

The question of reasonableness is not reached unless a "contract, combination, or conspiracy" in restraint of trade is found.[193] Both the

191. *See, e.g.*, PASHIGIAN, *supra* note 119, at 40 n.20.
192. Standard Oil Co. v. United States, 221 U.S. 1 (1911).
193. 15 U.S.C. § 1 (1970).

refusal to grant a new franchise and the termination or nonrenewal of an existing franchise constitute refusals to deal. Notwithstanding non-economic motives, every refusal to deal is a means of achieving or maintaining some degree of vertical control "such as [resale pirce stability], customer restrictions, or manufacturer or dealer exclusives."[194] The traditional approach to refusals to deal was announced in *Colgate.*[195]

Since that decision, unilateral decisions of a manufacturer not to do business with a former or would-be dealer are not subject to the antitrust law.[196] While *Colgate* was decided in the setting of resale price maintenance, its broad language is regarded as equally applicable to other restraints as well.

During the last fifty years *Colgate* has been distinguished and limited.[197] Only cases of Doric simplicity have a chance to pass through the narrow channel which the courts have left to the manufacturers.[198] However, even though *Colgate* apparently is "on the critically ailing list,"[199] cases of Doric simplicity are not as "rare in this day of complex business enterprise"[200] as Judge Moore assumed. As long as real cooperation between members of a dealer network and a manufacturer in detecting nonconforming dealers cannot be shown, the

194. Buxbaum, *Boycotts and Restrictive Marketing Arrangements*, 64 MICH. L. REV. 671, 676 (1966) [hereinafter cited as Buxbaum].

195. United States v. Colgate & Co., 250 U.S. 300 (1919). Without entering into formal agreements, Colgate had made clear to the wholesalers and retailers of its products that it would feel free to stop doing business with them if they did not adhere to Colgate's pricing policy. This practice was upheld. "In the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell." *Id.* at 307.

196. The presence of monopoly power may deprive the trader of his freedom to unilaterally refuse to deal with another. *See* Eastman Kodak Co. v. Southern Photo Materials Co., 273 U.S. 359 (1927).

197. *See, e.g.,* United States v. General Motors Corp., 384 U.S. 127 (1966); United States v. Parke, Davis & Co., 362 U.S. 29 (1960); United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944); Federal Trade Comm'n v. Beech-Nut Packing Co., 257 U.S. 441 (1922); United States v. Schrader's Son, Inc., 252 U.S. 85 (1920).

198. George W. Warner & Co. v. Black & Decker Mfg. Co., 277 F.2d 787, 790 2d Cir. 1960). *See also* Albrecht v. Herald Co., 390 U.S. 145, 150 n.6 (1968); Ford Motor Co. v. Webster's Auto Sales Inc., 361 F.2d 874, 880-81 (1st Cir. 1966); Carbon Steel Products Corp. v. Alan Wood Steel Co., 289 F. Supp. 584, 588 (S.D.N.Y. 1968).

199. Halper, *Individual Refusals to Deal: Customer Selection or Dealer Protection,* 22 ABA ANTITRUST 49, 50 (1963).

200. George W. Warner & Co. v. Black & Decker Mfg. Co., 277 F.2d 787, 790 (2d Cir. 1960).

manufacturer's refusal to deal with the nonconforming dealer is not classified as a boycott but as a unilateral business decision.[201] The courts have not been impressed by the argument that when all members of a distribution network are informed about their supplier's marketing policy, they adhere to it because they rely on compliance by all dealers and, therefore, the manufacturer is expected to remedy the situation instantaneously when one distributor "breaks out." The *Interstate Circuit* doctrine[202] is not invoked by the mere existence of a mutual understanding concerning the distribution policy to be observed. The fact that the manufacturer unilaterally announces and induces distribution policies apparently has been given more weight than the "invitation to a plan" language of *Interstate Circuit.* In two cases involving automobile distribution quarrels,[203] the allegation that an existing dealer had induced the manufacturer to cease dealing with another retailer was held insufficient to show conspiracy: "[A] manufacturer would not decide to reduce the number of its dealers in a particular city . . . without discussing the matter with . . . the . . . dealer whom it wished to retain."[204] Seemingly, the notion behind these decisions is that a manufacturer must be free under the antitrust laws to replace an existing dealer with a new one regardless of the hardship for the former dealer.[205] If a marketing practice seems illegal when viewed in the context of the entire market, other antitrust statutes supposedly will provide a basis for condemning the refusal to deal. Where marketing practices do not seem illegal in their market context, however, "boycott

201. Klein v. American Luggage Works, Inc., 323 F.2d 787 (3d Cir. 1963); House of Materials, Inc. v. Simplicity Pattern Co., 298 F.2d 867 (2d Cir. 1962).

202. Interstate Circuit, Inc. v. United States, 306 U.S. 208 (1939). The Court held than an invitation to conduct followed by the adoption of the invited conduct constituted a conspiracy for Sherman Act section 1 purposes. *Id.* at 227.

203. Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418 (D.C. Cir.), *cert. denied,* 358 U.S. 822 (1957); Schwing Motor Co. v. Hudson Sales Corp., 239 F.2d 176 (4th Cir. 1956), *aff'g per curiam* 138 F. Supp. 899 (D. Md. 1956), *cert. denied,* 355 U.S. 823 (1957).

204. Schwing Motor Co. v. Hudson Sales Corp., 138 F. Supp. 899, 906 (D. Md. 1956).

205. *See* Fulda, *Individual Refusals to Deal: When Does Single-Firm Conduct Become Vertical Restraint?,* 30 L. & CONTEMP. PROB. 590, 597 (1965). Usually courts have held that every nonmonopolistic manufacturer has the right to select dealers who will devote their time and energies to selling its products. No manufacturer should be forced to continue entrusting the marketing of its products to dealers with divided loyalties adverse to its interest. *E.g.,* McElhenney Co. v. Western Auto Supply Co., 269 F.2d 332 (4th Cir. 1959); Hudson Sales Corp. v. Waldrip, 211 F.2d 268 (5th Cir.), *cert. denied,* 348 U.S. 821 (1954); Deltown Foods, Inc. v. Tropicana Prods., Inc., 219 F. Supp. 887 (S.D.N.Y. 1963); United States v. J. I. Case Co., 101 F. Supp. 856, 864 (D. Minn. 1951); *accord,* McKessor & Robbins, Inc. v. Charles Pfizer & Co., 235 F. Supp. 743, 749 (E.D. Pa. 1964).

concepts should not be used to bootstrap the practice into illegality"[206] in the first place.

The fact that such marketing practices were not assailable under section 1 of the Sherman Act as long as they were unilaterally imposed and enforced did not find applause from all judges. In order to overcome a seeming weakness in section 3 of the Clayton Act,[207] Judge MacMahon led a bold attack in *Albert H. Cayne Equipment Corp. v. Union Asbestos & Rubber Co.*[208] He reasoned that "refusals to continue to deal unless the buyer join with the seller in a contract violative of the antitrust law are clearly illegal."[209] In his opinion, the application of Sherman section 1 did not require the existence of an outright conspiracy or any boycott element. The manufacturer's invitation "to enter into a bi-lateral contract on condition that the offeree bow to terms claimed to be illegal under the antitrust laws"[210] was considered sufficient for section 1 purposes.[211] If this opinion were endorsed on the highest judicial level, one unsound result of the Sherman Act would be overcome.[212] A dealer who refuses to enter a contract violative of the antitrust laws, and who suffers the termination of his franchise as a consequence of his refusal, would receive a treble damage award as a reward for his ability to resist under the *Cayne* doctrine.

However, to equate an invitation to a contract—the incipiency of any agreement—with a full-blown agreement strains the wording of section 1 of the Sherman Act beyond the limits set by Congress. This would be indefensible.[213] Moreover, the *Cayne* doctrine would not apply to cases wherein a manufacturer resorted to an unconditioned

206. Buxbaum, *supra* note 194, at 690.

207. 15 U.S.C. § 14 (1970). This section covers contracts, not refusals to contract.

208. 220 F. Supp. 784 (S.D.N.Y. 1963).

209. *Id.* at 787.

210. *Id.* at 786-87.

211. *See* Lessig v. Tidewater Oil Co., 327 F.2d 459 (9th Cir.), *cert. denied,* 377 U.S. 993 (1964); Osborn v. Sinclair Refining Co., 286 F.2d 832 (4th Cir. 1960), *cert. denied,* 366 U.S. 963 (1961).

212. *See* Albrecht v. Herald Co., 390 U.S. 145, 162 (1968) (Harlan, J., dissenting): "Obviously, it makes no sense to deny recovery to a pressured retailer who resists temptation to the last and grant it to one who momentarily yields but is restored to virtue by the vision of treble damages. It is not the momentary acquiescence but the punhsiment for refusing to acquiesce that does the damage on which recovery is based."

213. Judge MacMahon's view is not supported by the invitation to a plan language of Interstate Circuit, Inc. v. United States, 306 U.S. 208, 227 (1939) (invitation tacitly accepted). His double incipiency doctrine is equally as questionable. The market foreclosure required by section 3 of the Clayton Act is generated by the implementation of an agreement, not the invitation to an agreement.

nonrenewal or termination of a contract. Also, the doctrine would not apply when a manufacturer would not even seriously consider supplying a dealer-applicant in order to maintain its entrenched system of reliable outlets. Thus, the doctrine would not bring relief to the Navajo people or applicants in a similar position, unless the whole franchise distribution system of the automobile industry was regarded as an unlawful marketing practice.

A Departure from the Traditional Analysis

Assuming that the automobile manufacturers make their marketing decisions in cases such as the Navajo application independent of any communication with existing dealers, such actions would be unilateral refusals to deal. Strictly unilateral refusals in a nonmonopolistic context seemingly are not vulnerable under the traditional interpretations of Section 1 of the Sherman Act. However, three relatively recent Supreme Court decisions[214] support the contention that the relationship between a manufacturer and its dealer network constitutes a combination for antitrust law purposes.[214a] To be sure, neither *Simpson* nor *Schwinn,* at first glance, touch the problems which determine the scope of *Colgate,* since neither dealt with restrictions which were unilaterally imposed by suppliers. The restrictions in *Simpson* and *Schwinn* were parts of the contracts between supplier and retailer. Under the anti-trust laws it matters not whether such restrictions were thrust upon the dealer by his supplier or whether they were negotiated with mutual consent. They remain bilateral restrictions. Consequently, it makes no difference whether the manufacturer enforces the observance of these contractual restrictions unilaterally or in co-operation with other dealers. Therefore only *Herald* directly affects *Colgate.*

The new approach of the three decisions is found elsewhere. The Supreme Court evaluated the restrictions in the context of the restrictive distribution systems in their entirety. The mere fact that *standard* contracts were signed by the company and dealer in each case, thereby endowing the retail level with complete uniformity in its obligations and rights, provided an element of concert which was viewed as responsible for the particular market impact of the restrictions. In a similar way this basic element of concert is also present whenever members of a dealer network are forced, by fear of refusal to deal, to follow the

214. Albrecht v. Herald Co., 390 U.S. 145 (1968); United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967); Simpson v. Union Oil Co., 377 U.S. 13 (1964).

214a. The following analysis draws upon and elaborates concepts developed in the course of an analysis of territorial practices in the automobile industry done by Professor Lawrence A. Sullivan for the National Housing and Economic Development Law Project, University of California School of Law, Berkeley.

unilaterally announced marketing policy of their supplier. This basic element of concert, of course, does not cease to exist when a single dealer passively acquiesces or unsuccessfully tries to resist the particular anticompetitive policy upon which the manufacturer unilaterally decided.

The first of these three cases was *Simpson v. Union Oil Co.*[215] A gasoline station operator had taken a one year lease from Union Oil on condition that he sell its product on consignment at prices set by the company. After he cut the retail price for gas, Union refused to renew the lease. The Court found this arrangement illegal. Speaking for the majority, Justice Douglas failed to give clear criteria for the demarkation between agency and sales relationships. However, he did emphasize the use of such contracts in a "vast gasoline distribution system." Even though the case dealt with resale price maintenance, its pragmatic approach is applicable to every *systematic* restraint of trade in light of the function of the antitrust laws as a check on private economic power:

> When however, a "consignment" device is used to cover a vast gasoline distribution system, fixing prices through many retail outlets, the antitrust laws prevent calling the "consignment" an agency, for then the end result of *United States v. Socony-Vacuum Oil Co.* . . . would be avoided merely by clever manipulation of words, not by differences in substance. The present, coercive "consignment" device, if successful against challenge under the antitrust laws, furnishes a wooden formula for administering prices on a vast scale.[216]

When applied to refusals to deal in order to avoid explicit vertical restrictions, this approach would stress the impact of the manufacturer's refusal to deal when an elaborate retailer network exists rather than the distinction between bilateral and unilateral conduct.

The second of the cases which viewed the dealer network as a combination was decided three years after *Simpson*. In *United States v. Arnold, Schwinn & Co.*,[217] the Court held per se unlawful certain territorial and customer restrictions imposed by Schwinn on its twenty-two franchised distributors. Over ten years, its share of the bicycle market had declined nearly ten percent. In order to regain the lost ground, Schwinn distributed its products by sale to wholesalers who resold to a large number of franchised retailers and by direct sale to franchised retailers with a payment of commissions to the wholesaler

215. 377 U.S. 13 (1964).

216. *Id.* at 21-22. Referring to Klor's Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 213 (1959), Justice Douglas further remarked that "it matters not that the complainant may be only *one* merchant." 377 U.S. at 16 (emphasis added).

217. 388 U.S. 365 (1967).

placing the order on the retailer's behalf. Both wholesalers and retailers were free to deal with other brands of bicycles. However, wholesalers were not allowed to sell to retailers outside of exclusive territories; retailers were not alowed to sell to other unfranchised retailers. Both types of restrictions were considered to be "restraints upon alienation which are beyond the power of the manufacturer to impose upon its vendees and which, since the nature of the transaction includes an agreement, combination or understanding, are violations of Section 1 of the Sherman Act."[218] More importantly, the Court emphasized that restraints as to territory or customers, vertical or horizontal, are unlawful if they are ancillary to price-fixing and an "integral part of the whole distribution system."[219] As in *Simpson*, refusals to deal made in order to maintain a well balanced restrictive marketing system cannot go unaffected by this language.

The last Supreme Court decision to view a distribution system as a combination in the meaning of section 1 of the Sherman Act was *Albrecht v. Herald Co.*[220] There were two different combinations involved. Justice White based his opinion on a combination between the defendant newspaper publisher and two third parties who solicited subscribers for defendant's newspaper and temporarily served as a distributor on one newspaper home delivery route. The employment of these two parties was aimed at forcing one of defendant's distributors not to overcharge his customers and abide by the maximum resale price set by defendant. This price had been set in order to counterbalance the territorial exclusivity of the newspaper's distributors. While the decision is controversial in its treatment of the interplay between maximum price maintenance and territorial restrictions, the case is particularly important for its erosion of the traditional notions of conspiracy.[220a] Still more important for the analysis developed in this article is the

218. *Id.* at 377-78.

219. *Id.* at 375, *quoting* United States v. Bausch & Lomb Co., 321 U.S. 707, 720 (1944). The *Schwinn* decision was foreshadowed by the dissent in White Motor Co. v. United States, 372 U.S. 253 (1963): "The motivations of White Motor and its distributors and dealers are inextricably intertwined; the distributors and dealers are each acquainted with the contracts and have readily complied . . . without which the contracts would be of no effect. It is hard for me to draw a distinction on the basis of who initiates such a plan. Indeed, under *Interstate Circuit* . . . the unanimity of action by some 300 parties here forms the basis of an 'understanding that all were to join,' and the economies of the situation would certainly require as much." *Id.* at 280 (Clark, J., dissenting).

220. 390 U.S. 145 (1968).

220a. With respect to the members of the combinations being attacked, compare Albrecht v. Herald Co., *id.*, with United States v. Parke, Davis & Co., 362 U.S. 29 (1960).

Court's obvious and plain reference to the existing scheme of price fixing: "The combination with retailers arose because their acquiescence in the suggested prices was secured by threats of termination. . . ."[221] The combination enjoined was not the distribution as such. However, the Court's opinion supports the view that unilateralism and combination are not necessarily antagonistic.

The refusal to deal with the Navajos was, of course, of a different sort than *Herald* dealt with. It was not that a rebelling dealer was to be brought into line by threats of exclusion from the dealer network, but rather that the balance of the distribution system was to be maintained by keeping the number of dealers constant. The Navajo case therefore resembles the sole outlet decisions,[221a] except that General Motors' decision was supposedly not dependent upon any communication with affected dealers. However, the new combination approach of the Supreme Court is equally applicable here. It bridges the gap between bilateral and unilateral sole outlet decisions, as it does between unilaterally announced and bilaterally negotiated marketing policies.

None of the cases outlined above dealt explicitly with how far a manufacturer can go in enforcing its marketing policy. In the area of a single sales relationship absent an elaborate distribution pattern or system, *Colgate* may still be alive.[222] This bow of reverence before the ancient *Colgate* doctrine, however, cannot deter the use of the Supreme Court's language for the *combination* element in the context of the automobile distribution system. Although combination and conspiracy are not synonymous, they have equal rights in the interpretation of section 1 of the Sherman Act. The analysis arising from a reading of *Simpson, Schwinn* and *Albrecht* lays *Colgate* to rest. The unilateralism test is replaced by a test which allows a much better differentiation in evaluating the competitive impact of all types of refusals to deal. The elaborate distribution system is the basis for finding the requisite combination. This combination inherently restrains trade.[223] Then, the manufacturer's decisions—unilateral or bilateral—affect this restraint; they animate it; they mitigate or strengthen it each time anew. The nature and effect of the restraint thus accomplished can only be ascertained and evaluated as to its reasonableness in the context of the entire structure of the production and retail levels of the automobile industry.

One possible objection to this procedure is that the combination

221. *Id.* at 149.
221a. See note 263 *infra*.
222. See cases cited in note 201 *supra*.
223. See text accompanying notes 191-92 *supra*.

analysis is based on cases in which the particular anticompetitive policy would be a per se violation if concertedly adopted. *Simpson* and *Albrecht* involved resale price maintenance.[224] In dealing with territorial resale restrictions, *Schwinn* held such restrictions illegal per se for the first time.[225] Except possibly for the location clause,[226] none of the automobile manufacturers' distribution practices fit into these two or any of the other per se categories. The practices do not have the "pernicious effect on competition and lack of any redeeming virtue" that justifies the conclusive presumption of their unreasonableness and therefore renders them "illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."[227] However, the logic of the combination analysis does not demand its restriction to per se violations. Any other restraint of trade arising from the management of a distribution system is susceptible to a test of its reasonableness.

Reasonableness

The reasonableness of a combination is not subject to any rule of thumb:

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.[228]

Either the purpose of the combination or its effect must unreasonably restrain competition. When this rule of reason test is applied to re-

224. Resale price maintenance was first outlawed in Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

225. *But see* Northern Pacific Ry. v. United States, 356 U.S. 1, 5 (1958), *citing* United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899), for the proposition that allocation of markets is illegal per se.

226. See text accompanying notes 250-66 *infra*.

227. Northern Pacific Ry. v. United States, 356 U.S. 1, 5 (1958).

228. Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918). After *Schwinn*, the following can be added; "But the antitrust outcome does not turn merely on the presence of sound business reason or motive. . . . Our inquiry is whether . . . the effect on competition in the market place is substantially adverse." United States v. Arnold, Schwinn & Co., 388 U.S. 365, 375 (1967).

fusals to deal on the basis of efficiency regulation, they must be held illegal as an unreasonable restraint of trade, at least in all those non-metropolitan areas where competition from small companies is negligible or non-existent.

The purpose of dealer efficiency regulation is to maintain profitability.[229] The maintenance of profitability encourages dealer investment which contributes to consumer brand attachment. The struggle for general consumer satisfaction certainly prevents the automobile manufacturers from purposefully neglecting benefits to the public. Presumably, since the Big Three undoubtedly are aware of their antitrust vulnerability, they have not intended to extinguish their small competitors. Also, the automobile intrinsically requires a system for orderly distribution. This system must include maintenance and repair facilities as well as repair parts outlets. The subjective prerequisites for granting dealership franchises—cash, character, and capacity—are undoubtedly reasonable even though they inevitably limit the degree of retail and service competition. The public is best served if retailers are experienced, reliable, capable and honest. The cash requirement contributes to an efficient allocation of resources. An applicant's willingness to invest a portion of the necessary working capital indicates an expectation that automobile retailing in an area will be profitable. In this way, the requirements of the market place establish the allocation of resources.

While the subjective prerequisite do not run afoul of a rule of reason analysis, the objective prerequisites[230] for granting a dealership franchise unduly restrain trade. In evaluating these objective considerations, three elements must be reviewed: their effect on *interbrand* competition, their effect on *intrabrand* competition, and their effect on the accessibility to products and services for potential and actual customers. The current dealer efficiency regulation affects interbrand competition adversely. Dealership operation requirements for non-Big Three dealers are enlarged, thereby aggravating market penetration by small competitors. This is especially true in rural areas. Turned upon the overall competitive structure in the automobile industry, any further weakening of the limited competitive stimuli—both actual and potential—is entirely unreasonable.

A consideration of the effect of the objective prerequisites on intrabrand competition is necessitated by the overall competitive situation in the automobile industry. If there were a dozen or more domestic

229. See text accompanying note 182 *supra*.
230. See text accompanying note 187 *supra*.

passenger car manufacturers of comparable size, intrabrand competition in the sale of any one manufacturer's product hardly would be subject to review. However, three manufacturers produce the vast majority of domestic output. Even though interbrand competition exists in the nonprice area, intrabrand competition is a most important competitive element at the retail level. Price and service competition desperately need every possible animation in a structural setting that limits the number of competitors to three in areas where the market penetration of small competitors is virtually negligible. Encouraging intrabrand competition may increase dealer turnover rates in areas where potential sales volume will not support two dealers. Sometimes one General Motors, Ford or Chrysler dealer may be well above the necessary profitability level. Yet, the addition of a second dealer would threaten the existence of both. Where, for example, annual sales of 200 cars are the minimum level for covering costs including a normal return on investment and where the actual sales potential is 260 or 300 cars, either the additional dealership is not viable or the established dealer will finally be driven out. This increase in dealer turnover would lessen consumer-dealership attachment advantages. Arguably, the public would benefit from the survival of the more capable of the two dealers. Where the manufacturers have not recovered their investments in an existing dealership, certainly they will not contribute to a possible erosion of their recovery prospects by granting an additional franchise. However, sound business reasons do not immunize conduct otherwise illegal.

> It is only if the conduct is not unlawful in its impact in the marketplace or if the self-interest coincides with the statutory concern with the preservation and promotion of competition that protection is achieved.[231]

In conjunction with curtailing intrabrand competition, dealer efficiency regulation based on market surveys and forecasts effectively denies some consumers access to the product and service. This is demonstrated by the situation on the Navajo reservation. Not every car owner can be accompanied constantly by a service mechanic. Also, many consumers in rural areas undoubtedly must travel greater distances than metropolitan inhabitants to a dealer. The concept of the area of primary responsibility usually guarantees a certain degree of market cultivation that gives every customer reasonable access to a new car and proper authorized service. When, however, manufacturers substitute their marketing decisions for competitive developments

231. United States v. Arnold, Schwinn & Co., 388 U.S. 365, 375 (1967).

through efficiency regulation, the demands of the marketplace go unexecuted. This is unreasonable in the light of the industry structure at both the production and the retail level.

In summary, dealer efficiency regulation, as manifested in objective prerequisites to the granting of a franchise, unreasonably restrains trade because of its effects on interbrand and intrabrand competition and customer access to the product and service. The decision not to negotiate further with franchise applicants such as the members of Tsegi Motors and thereby not to follow an obvious demand of a community perpetuates the existing noncompetitive dealership structure. Where the demand can be satsified on an economically feasible basis,[232] the manufacturer's refusal to grant the franchise is an unreasonable management of a distribution system combination. These activities are subject to attack for violating section 1 of the Sherman Act.

Suggested Remedies to Dealer Efficiency Regulation

To comply with section 1 of the Sherman Act, the automobile manufacturers would have to adopt and to implement marketing policies which assure sufficient dealership in every geographic segment of the American market. This would provide for a reasonable degree of intrabrand competition and accessibility to products and services. Emphasis necessarily would shift from maintaining consumer attachment to existing dealerships. This development would tend to facilitate market penetration in rural areas by small firms. Thus, interbrand competition would be enhanced wherever entry barriers of distribution were not prohibitively high due to *natural* economies of scale.

With these considerations in mind, the drafting of an appropriate remedy would not be problematic. The manufacturers would be obliged to adopt and make public objective standards which lead to the required dealership density. Their determinations of the number of outlets would be subject to governmental review. This is not to suggest that the government interfere with the dealership structure as such (e.g., by ordering General Motors, Ford and Chrysler to increase intrabrand competition by the establishment of factory-financed outlets). Such intereference would have an immensely regulatory character; the history of regulation in the United States demonstrates that it seldom approaches an optimum resource allocation. Moreover, the problems in defining the size and number of dealerships in each geographical submarket would be insuperable, especially in light of changing demand conditions. The initiative for changes should always come

232. See note 188 *supra*.

from dealers on the retail level who see an opportunity to invest their money profitably in automobile retailing.[232a] However, the government, as well as prospective applicants for dealerships, must know which standards have to be met. Without such knowledge, enforcement of those reasonable standards through antitrust law actions would be impossible.

A further step would be to require the Big Three to accept every dealership application. Such an order would raise several practical difficulties. Among these would be determining which capital requirements must be met by a potential retailer. If the manufacturers prescribed the standards for service facilities, car and repair part inventories, showroom size, advertising contributions and so forth, the cash requirement probably would deter most applicants. The situation on the retail level would remain basically unchanged.

If the injunction restrained the companies from making car delivery dependent on such factory-imposed conditions, big department stores and used car dealers would be likely to enter a new car retailing. However, such an order does not find its basis in the suggested interpretation of section 1 of the Sherman Act. The franchise distribution system inevitably would die. Opening the automobile retail market to an indeterminable number of outlets would destroy the combination character of the dealer network upon which the antitrust attack was founded. Without partial mutuality of interest between the participants, no combination is inherent in the distribution system. In the automobile industry this mutuality is achieved through the manufacturer's efficiency regulation. Under an order requiring the acceptance of all applications, the manufacturers would have no control over the economic viability of their dealers. The present system of market surveys would become obsolete except for rough output determinations. The single dealer would no longer enjoy a limited guarantee that he can survive economically under normal business conditions as a member of a well balanced network of selected dealers. Of course, this guarantee always is subject to changes in the dealership structure as required by the antitrust laws. However, existing dealers reasonably can expect their supplier to demand that new applicants fulfill a prerequisite which all existing dealers were required to meet—the prerequisite of providing adequate service facilities in accordance with the manufacturer's reasonable standards. The demise of this prerequisite would lead to two types of dealers within the respective distribution network. The combination approach would no longer be valid. Those who believe that a better

232a. See text accompanying note 230 *supra.*

distribution device for the automobile industry is conceivable will have to look for another legal leverage.

The Location Clause

The Big Three's dealer efficiency regulation has established a balance within their respective dealer networks.[233] This self-restriction in granting new franchises protects existing dealers from vigorous intrabrand competition. This, in turn, facilitates market forecasts, production plans and the implementation of marketing strategies. Another means to achieve these benefits would be territorial restrictions imposed on existing dealers. These restrictions may be welcomed by dealers because protection from intrabrand competition aids the dealership's profitability and the thorough cultivation of the territory. Thus, the negotiation of territorial restrictions would not be difficult.

The History of Territorial Restrictions in the Automobile Industry

Prior to World War II, territorial restrictions were common in automobile franchise agreements. However, in 1949, these restrictions succumbed to the side effects of the Supreme Court's decision in *Standard Oil Co. of California v. United States.*[234] By 1952, following the advice of the Justice Department, all manufacturers had eliminated territorial limitation clauses. The clauses were replaced by an area of primary responsibility concept which obligated the dealer to cultivate his area to the full satisfaction of the manufacturer. If the manufacturer was satisfied, the dealer could make more than occasional sales in other territories. Despite this remnant of territorial security, some members of the industry were dissatisfied with the partial demise of restrictions.[235]

Part of this dissatisfaction grew out of bootlegging,[236] which was an important feature of the reappearance of a buyer's market in 1953.[237] What had existed in the 1920s in scattered areas "now, en-

233. The achievement of this balance is directly proportional to the number of *exclusive* dealers in a manufacturer's network.

234. 337 U.S. 293 (1949).

235. See generally WHITE, *supra* note 3, at 163.

236. The term "bootlegging" refers to a situation in which a franchised dealer sells new cars to nonfranchised retailer. This nonfranchised retailer then sells the bootlegged cars in competition with franchised dealers who are responsible for the area under the area of primary responsibility concept.

237. Following the stabilization of the Korean War defense situation, material controls were removed after March 1953. Subsequently, the supply of cars was greatly increased, and in the struggle for volume leadership all manufacturers fully exploited their production capacity. The end of the easy postwar selling conditions was reflected by a decline in dealer profits. *See* EDWARDS, DYNAMICS, *supra* note 3, at 29.

couraged by an apparently new legal climate returned in epidemic and malignant forms."[238] Bootlegging reached its peak in 1955 and 1956.[239] This horrified the automobile manufacturers, and they "came to grips with bootlegging notwithstanding the antitrust briar patch and advised their dealers that if they engaged in bootlegging it could be reasonable to suspect that they were not fulfilling their franchise obligations."[240] The dealers and the manufacturers launched attempts to curtail bootlegging.[241] General Motors proposed a new clause for its selling agreement requiring dealers to offer inventories back to General Motors before selling them into bootleg channels. The Attorney General, however, refused to waive criminal proceedings if this clause was inserted since it raised important antitrust questions.[242] Informal actions failed. For example, in the 1955 model year General Motors offered to repurchase excess supply from its dealers, but few dealers took advantage of this offer.[243]

A problem closely akin to bootlegging not in form but in its effect on the dealer body was the establishment of new branch outlets by existing dealers.[244] This can threaten profitability and complicate the execution of the area of primary responsibility concept. Moreover, market forecasts become less precise due to intrabrand fluctuations. Therefore, the location clause provides that:

> [The] Dealer shall not, either directly or indirectly, establish any place or places of business for the conduct of any of its Dealership Operations except at the locations and for the purpose described in a current Statement of Dealership Premises that has been executed as provided in Subsection A of this section.[245]

The Effects of the Location Clause

The location clause inherently limits the dealer's ability to reach

238. SLOAN, *supra* note 129, at 298.

239. Heuerman, *Dealer Territorial Security and "Bootlegging" in the Auto Industry*, 1962 WIS. L. REV. 486, 488 [hereinafter cited as Heuerman]. *See generally* WHITE, *supra* note 3, at 41-42.

240. Heuerman, *supra* note 239, at 488.

241. *See* MACAULAY, *supra* note 143, at 44-48.

242. *Hearings on H.R. 528, 2688 & 6544 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 84th Cong., 1st & 2d Sess. 359 (1956) (testimony of Stanley N. Barnes, Assist. Att'y Gen. in Charge of Antitrust Division).

243. SLOAN, *supra* note 129, at 299.

244. *See* note 122.

245. GM, Chevrolet Dealer Sales and Service Agreement, Section 5B, form no. GSD 202 S, USA 8-70. The Dodge Direct Dealer Agreement Terms and Provisions § 7a are less explicit but not unequivocal: "Direct Dealer agrees to sell energetically at retail in the Sales Locality described in Paragraph 1 of this agreement. " *Id.*, app. XX, at 867.

customers outside his market segment.[246] The size of this segment varies according to the shopping habits of customers, traffic connections and population density. Even though a dealer is free to sell to customers wherever they may be located, the location clause secures market segmentation which effectively allows the manufacturer to control the degree of intrabrand competition. The location clause factually restricts the dealer's business activities directly in terms of teritorial freedom and indirectly in terms of freedom of customer choice. This goes far beyond the area of primary responsibility clause which does not confine the dealer to any area. The area of primary responsibility clause enables the dealer to sell everywhere. As long as he fulfills his representation obligation in his own backyard, sales in other territories will not influence the evaluation of his sales performance. On the other hand, the location clause reminds the dealer that the grass is greener on his own side of the fence. It may be characterized as taking away from the dealer what the area of primary responsibility clause gives. However, this characterization is too generous. The area of primary responsibility clause does not grant anything. It merely reflects the basic idea of antitrust law that businessmen should be able to gear their activities to the demands of the market—not to the superior economic power and bargaining position of a manufacturer. In the context of automobile dealerships, the location clause constitutes a flat territorial prohibition.[247] Any other conclusion would be a gross distortion of the hard economic facts.

Unlike traditional territorial security provisions, the location clause cannot be classified as a device to prevent a "cream skimming." Those in favor of territorial restrictions usually advance the argument that absent such restrictions dealers will not undertake costly selling activities. They will not cultivate the less lucrative accounts of their area but will rely partially on the efforts of others, thereby in effect obtaining a free ride.[248] Low cost sales to brand-attached nonshoppers in other dealers' territories are denounced as "cream skimming." When such sales occur, the dealer responsible for the area may have difficulties in amortizing his investment. The establishment of a new

246. *See Restricted Channels, supra* note 138, at 798-99 n.17.

247. Closely related to the location clause in effect are profit passover provisions. These provisions appear in two forms: (1) If dealer *A* sells a car in the territory of dealer *B*, *A* is obligated to deliver his entire profit to *B*; (2) if dealer *A* sells a car in the territory of dealer *B*, *A* is obligated to pay a fixed amount to *B* which is to cover *B*'s expenses accruing from servicing the car.

248. *But see* Comanor, *supra* note 148, at 1432-33. *See also id.* at 1428-32 (rebutting the notion that territorial limitations encourage dealer investment and provide dealer service as well as complete market coverage).

sales outlet would rebut any intention to engage in "cream skimming." A new outlet requires large financial investment.[249] A dealer who risks the investment for a new location, new facilities and a full inventory is not doing so to steal a few "fat deals" from an already established dealer. Of course, the new dealer's intention to achieve a profitable basis may endanger the established dealer and increase dealer turnover. These are merely the effects of any intrabrand competition, and automobile dealers should not be exempt from it.

One possible objection to the stimulus of increased intrabrand competition is that a dealer might engage in predatory selling in the market segment served by his new branch. After he has driven the established dealer out of the market, the new dealer could exploit his local monopoly by raising his prices. This objection is unsound. Incurring losses through predatory selling is economically rational only when the prospect of subsequent supracompetitive gains exists. However, every dealer remains subject to *interbrand* competition which limits his ability to raise prices. Furthermore, if dealership density is competitively arranged, customers can switch readily to another dealer of the same brand. Therefore, is a manufacturer has established an appropriate dealership density in the first place, local monopolies are unlikely. If the density is otherwise, intraband competition so far has been suppressed; the activities of the expanding dealer should be encouraged by the law.

If a dealer, who opens a second outlet, neglects his representation duties in his first dealership area, he will lose his franchise for failure of performance. This result would affect both places of business. Therefore, any dealer will consider carefully whether this venture into another area is within reasonable risk limits. If he decides to expand his business activities after weighing all factors, he should not be restricted in doing so. The manufacturers raise the argument that their detailed market surveys provide the best knowledge of what the market can bear. This argument is ambiguous. If the manufacturers' decisions are fully harmonious with demand, reliance can be placed on market forces. Dealership contracts would not have to include location clauses.

In summary, the automobile manufacturers effectively have achieved control over intrabrand competition through the location clause in connection with their dealer efficiency regulation. The clause, which cannot be explained as a device to prevent "cream skimming," has no economic justification. It merely substitutes the manu-

249. See text accompanying notes 126-29 *supra*.

facturers' decisions for those which a dealer should make on the basis of the dictates of the market.

The Location Clause and Section 1 of the Sherman Act

If the location clause is viewed as preserving the area of primary responsibility concept, it would be classified as an ancillary restraint. However, the area of primary responsibility concept would remain feasible even if the location clause was held to be illegal. The presence of intrabrand competition makes the evaluation of a dealer's market performance more difficult, particularly in times of rapidly shifting demand. Nevertheless, automobile manufacturers have shown remarkable ingenuity in developing meticulous market surveys and analyses. These same manufacturers should not find the hurdle of inventing new reasonable performance standards insurmountable. Rather, the discussion reduces to the general question of whether intrabrand competition should be sacrificed for the benefit of allegedly enhanced interbrand competition.[250] In the context of the automobile industry this question must be answered in the negative. When interbrand price competition and the variety of products within each price class is as limited as in the American automobile industry, any stimulus of intrabrand competition must be welcomed. Any impediment can be defended only by its indispensability. If the location clause were the only means available to secure adequately functioning service markets, it might be tolerable. However, the profitability of the service market[251] prevents this conclusion. The location clause rather seems to contribute unnecessarily to product differentiation barriers for new competition and to the financial strength of established dealers. The clause enhances customer-dealer attachments by reducing the dealer turnover rate. While product differentiation and its companion—low consumer substitutability—often result from real differences among products or from the peculiar skills of particular firms, the price and market power effects of product differentiation in the automobile industry are not offset by social gains accruing from the existence of product variety.[252] Hence, whether one or two retailers of one brand exist in a given area does indeed make a great difference.

250. Not all the reasons for or against territorial restrictions are discussed. This article is limited to the decisive features in the automobile industry.

251. PASHIGIAN, *supra* note 119, at 202. During the war period (1942-45), profit rates of automobile dealers who did no new car business were persistently higher than those of independent repair facilities. "Service was profitable during the war, and there is no reason to believe it is not so now." *Id.* This belief was buttressed by several automobile dealers in the San Francisco Bay area in interviews with the author.

252. See text accompanying note 148 *supra*.

Because the effect of the location clause is as detrimental to competition as the effect of any flat territorial restriction, it constitutes a per se violation of section 1 of the Sherman Act.[253] In the *Schwinn* case,[254] where retail sales were formally free from territorial restrictions but confined as a practical matter, the Supreme Court unequivocally held that

> [T]he decree should similarly enjoin the making of any sales to retailers upon *any* condition, agreement, or understanding limiting the retailer's freedom as to where and to whom it will resell the products.[255]

The Court was concerned not only with explicit territorial restraints but with *any* device which had the purpose or effect of keeping competitors out of the same geographical markets.

This concern was in line with the Supreme Court's insistence that the antitrust laws deal with the substance and not the form of restraints.[256] If the automobile manufacturers were allowed to confine each dealer to a retail area by spacing selling locations and then forbidding sales except from those locations, the *Schwinn* rule would be completely nullified. Form would triumph over substance. Such a result would be indefensible particularly in light of the recent decision of *United States v. Glaxo Group, Ltd.*[257] In that case, the court stated that *Schwinn* is to receive a broad and spacious, rather than a narrow and crimping, reading. This recent treatment of territorial restrictions was foreshadowed by several consent decrees[258] and legal comments.[259]

In view of this evolution, to dust off the old *Boro Hall* decision[260] and add that the location clause was not rendered unlawful in *United States v. General Motors Corp.*[261] thereby concluding that "the Schwinn decision does nothing to change prior law on the subject"[262] is questionable at best. Equally fallacious is the contention that the location clause is lawful as long as the manufacturer lawfully can grant

253. See text accompanying notes 246-48 *supra.*

254. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

255. *Id.* at 378 (emphasis added).

256. *See* Simpson v. Union Oil Co., 377 U.S. 13, 18 (1964); Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346, 354 (1922).

257. 302 F. Supp. 1, 8-11 (D.D.C. 1969), *rev'd on other grounds,* 93 S. Ct. 861 (1973).

258. Zimmerman, *Distribution Restrictions after Sealy and Schwinn,* 12 ANTITRUST BULL. 1181, 1187 n.8 (1967).

259. *E.g.,* Note, *The Supreme Court, 1962 Term,* 77 HARV. L. REV. 62, 172 (1963).

260. Boro Hall Corp. v. General Motors Corp., 124 F.2d 822, *rehearing denied,* 130 F.2d 196 (2d Cir. 1942), *cert. denied,* 317 U.S. 695 (1943).

261. 384 U.S. 127 (1966).

262. Pollock, *Alternative Distribution After Schwinn,* 63 NW. U.L. REV. 595, 603 (1968) [hereinafter cited as Pollock].

exclusive franchises.[263] These two types of restrictions are vastly different in terms of market impact. By an exclusive franchise agreement, a manufacturer voluntarily restricts itself. However, when the manufacturer imposes resale restrictions it exercises control over one of the most crucial competitive decisions which any truly independent tradesmen must make—where and to whom he will sell his wares. To claim that granting an exclusive franchise is a lawful restraint of alienation on the manufacturer's part[264] and to deny any analytical difference to restraints of alienation imposed on members of the next economic level is legal nonsense.

Even though the location clause is illegal on the basis of *Schwinn*,[265] the automobile distribution system will continue to function. The automobile manufacturers still can subject their dealers to certain standards of full line display, inventory keeping and warranty service. These representation obligations simply compensate for the advantages received by the dealer through the utilization of the manufacturer's goodwill. Any further requirements, however, are unjustified from the public point of view. The desire of the car makers to have their dealers invest funds in fancier showrooms instead of new locations is understandable as sound business because of product differentiation effects. However, this desire is not consistent with that of the public to have funds allocated in a way that best serves competition and its outcome.

Such a straightforward attack against the location clause strikes a strange contrast to the rather reluctant remedies suggested in connection with dealer efficiency regulation. Indeed, if the automobile manufacturers must cease to use the location clause in franchise contracts, new retail outlets conceivably would be opened by established dealers in conflict with the manufacturers' dealer spot determination. If the

263. Sole outlet decisions are valid restraints of trade as long as they are reasonable. *See* Seagram & Sons, Inc. v. Hawaiian Oke Liquors, 416 F.2d 71 (9th Cir. 1969), *cert. denied* 396 U.S. 1062 (1970); Packard Motor Co. v. Webster Motor Car Co., 243 F.2d 418 (D.C. Cir.), *cert. denied* 358 U.S. 822 (1957); Top All Varieties, Inc. v. Hallmark Cards, Inc., 301 F. Supp. 703 (S.D.N.Y. 1969).

264. Pollock, *supra* note 262, at 603.

265. The *Schwinn* decision has been criticized as being inconsistent in dichotomizing the legal analysis into the consignment and independent businessman categories. *See* Comanor, *supra* note 148, at 1422. "These property concepts indeed seem arbitrary if antitrust law is viewed as an economic engineering project. However, the Schwinn rationale makes better sense when it is realized that the Sherman Act deals with the concept of permissible power. By the title, risk and dominion rationale, the Court seems merely to articulate a point beyond which one economic unit is not permitted to limit the freedom of action of another." *Distribution Practices, supra* note 1, at 105.

location clause until now was a bulwark against new car sales through department stores and other referral outlets,[266] the discounters might intrude into the franchised dealer network. However, in contrast to an order to sell new cars to virtually everybody who places orders and pays cash, the loss of the location clause is unlikely to lead to a mushrooming of new outlets. In order to be competitive, new branches would require a high investment. This investment would approximate that which went into the first outlet. Therefore, with the elimination of the location clause from franchise contracts, the freedom of dealers as to where and to whom they will sell will be increased. This probably will lead only to sporadic changes in the distribution pattern and will not affect the viability of the franchised distribution system. The principal result of the demise of the location will be the preservation of the dealer's freedom to do business. At least in some areas, intrabrand competition will be enhanced, and the manufacturers' stifling of intrabrand competition will be replaced by the operation of market forces.

Proposed Legal Treatment of Firms in the Automobile Industry

The illegality of the location clause and dealer efficiency regulation under Sherman section 1 raises the question of whether an antitrust attack should focus on all competitors in the automobile industry, only the Big Three, or General Motors alone. Presently, discrimination should be exercised in the analysis of the restraints of trade which are inherent in the combination between manufacturers and their dealer networks—that is, in the analysis of dealer efficiency regulation. The history of the automobile industry demonstrates that newcomers and small competitors experience difficulties in their attempts to form and maintain strong dealer bodies. Yet, their contribution to competition ultimately depends on the reliability and strength of their retail outlets. Little will be gained by the possibility of enhanced intrabrand competition among American Motors dealers. Unless dealer spot determination of the small firms is blatantly arbitrary, the antitrust laws should not interfere with the small competitors' struggle to gain a foothold in the automobile market. This argument is especially sound in light of the situation in rural areas. In these areas the question normally is whether one outlet of a small company and the resultant increased interbrand competition is possible or economically feasible in the first place. The market penetration disadvantage of these small car producers is particularly evident in sparsely populated

266. *See* United States v. General Motors Corp., 384 U.S. 127 (1966).

areas. Their dealer spot determination hopefully is a strategem in their fight for existence rather than dealer efficiency regulation influenced by product differentiation considerations.

As far as the unlawfulness of the location clause is concerned, the general rules developed for territorial restrictions apply. Even the advocates of a strict per se approach do not deny that "some form of restraint on competition may be necessary to encourage the development of the distribution facilities which are needed to market successfully a new product or to promote successfully the entry of a new firm."[267] Moreover, American Motors' declining market share may merit application of the failing company defense.[268] Both of these excuses are intended to encourage a new or failing company's dealers to risk their investment. The application of these excuses is countered by the possibility that less restrictive methods are available. For example, an exclusive franchise containing a primary responsibility clause arguably will serve to make small companies more effective competitors through the increased promotion efforts of their dealers.[269] Therefore, in light of this alternative, new entrants and failing companies in the automobile market would be required to show extreme necessity for the location clause. However, this discussion of the availability of defenses to the inclusion of location clauses by newcomers and failing companies may be merely rhetorical. As a practical matter, their dealers' financial strength will seldom allow the establishment of new branches. The newcomer and failing company defenses have practical relevance only in situations involving discount houses. Whether these outlets fall within the scope of the location clause is still unanswered.[270]

Of decidedly more importance is whether an antitrust attack should discriminate between General Motors on the one hand and Ford and Chrysler on the other. With regard to the location clause, no reason for a differential treatment is conceivable. However, in the area of dealer efficiency regulation, discrimination in legal treatment may be necessary. Such an approach could be based on Judge Wyzanski's decision in *United States v. United Shore Machinery Corp.*[271] In

267. Comanor, *supra* note 148, at 1438.

268. *See* Sandura Co. v. FTC, 338 F.2d 847 (6th Cir. 1964). *See also* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 374 (1967).

269. *See* White Motor Co. v. United States, 372 U.S. 253, 271 (1963) (Brennan, J., concurring); Note, *Newcomer Defenses: Reasonable Use of Tie-Ins, Franchises, Territorials and Exclusives*, 18 STAN. L. REV. 457, 469-70 (1966).

270. *See* United States v. General Motors Corp., 384 U.S. 127 (1966).

271. 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).

his remedy opinion, he developed the different economic category concept.[272] Undoubtedly, General Motors' massive size, market share and power are salient characteristics of the automobile industry. However, Ford and Chrysler are by no means dwarfs.[273] As long as General Motors cannot be labeled a monopolist, claims that it "has already put itself in a class different from any of its competitors"[274] would be difficult to maintain. Moreover, the proposed antitrust actions are designed to benefit the public. Thus, there is little reason to allow Ford and Chrysler to continue marketing policies which are detrimental to the public and small competitors.

Conclusion

The management of the automobile distribution system artificially increases barriers to competition. This places small manufacturers and potential newcomers at a definite disadvantage. Workable competition is threatened by dealer efficiency regulation which reduces both intrabrand and interbrand competition. Furthermore, such regulation is a possible source of a shortage of intercorporate dealerships. Section 1 of the Sherman Act is an appropriate tool to remedy these threats. Its application is dependent on a finding that a single dealer-manufacturer network constitutes a vertical combination. An injunction of the unreasonable restraints of trade stemming from the management of this combination will not affect the manufacturer's reasonable desire for adequate promotion of its products, honest representation of its image and preservation of its public good will. Subjective and objective standards which reflect marketing necessities intrinsic in the automobile still can be adopted and implemented. However, this may be too little in exchange for the paradise lost—the paradise of undisturbed retail market determination and intrabrand competition regulation. From the manufacturers' standpoint, adequate representation may no longer prevail. Their response could be vertical integration.

Predictions of vertical integration in industries have proved to be remarkably unreliable in the past. Justice Douglas dissented from the Supreme Court's decision in *Standard Oil Co. of California v. United States*[275] on the basis that the Court unwisely would hold vertical ownership integration lawful. He feared that oil refiners would be encouraged to replace independent small business service stations with

272. 110 F. Supp. at 350.
273. See note 5 *supra*.
274. 110 F. Supp. at 350.
275. 337 U.S. 293 (1949).

their own outlets and employees after the Court held Standard Oil's exclusive requirement contracts unlawful. Justice Douglas' prophecy that the "small, independent business man will be supplanted by clerks. . . . The situation is not ideal . . . [but] the alternative which the Court offers is far worse. . . The Court approves what the Anti-Trust Laws were designed to prevent"[276] was not validated by time.[277] In the *Schwinn* case,[278] the government discarded the probability of vertical integration as a hollow threat.[279] The unchanged distribution system in the oil industry seemed to lend support to the government's view. However, Justice Stewart, dissenting in *Schwinn*, reiterated Justice Douglas' fear. The *Schwinn* dissent was closer to the truth:[280] "In Galbraithian terms, Schwinn has replaced the strategy of control of the market with the strategy of superseding the market."[281] In August 1967, Schwinn announced to its dealers and distributors that it was planning ultimately to distribute its bicycles and other products through factory-owned sales subsidiaries. Nine independent distributors were immediately terminated as of December 31, 1967, and Schwinn has subsequently repurchased these distributors' remaining inventory of Schwinn products.[282]

However, Schwinn is not General Motors, Ford or Chrysler. The costs of carrying cars, parts and accessories and providing repair facilities are far greater than those for distributing bicycles. As long as a majority of dealers resist the manufacturer's attempts to buy them out, the loss of experience, local reputation and buyer-dealer attachment will accumulate with the costs of vertical ownership integration. The prospect of seeing many "old" dealers devoting their investment, experience and efforts to small competitors would further deter the Big Three from vertical forward integration. As long as planning in terms of production and market penetration is not severely hampered by the development of a random distribution system, the Big Three are unlikely to shift away from a system of selected, franchised dealers. "Inability to agree upon certain restrictions does not mean that distribution automatically becomes a rat's nest of chaotic, inefficient, fly-by-night competition. Indeed, the willingness of a number of companies to

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276. *Id.* at 320-21 (Douglas, J., dissenting).
277. *See* Simpson v. Union Oil Co., 377 U.S. 13 (1964).
278. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).
279. Pollock, *supra* note 262, at 610 n.60.
280. 388 U.S. at 384 (Stewart, J., dissenting).
281. *Distribution Practices, supra* note 1, at 108.
282. Keck, *Alternative Distribution Techniques—Franchising, Consignment, Agency and Licensing*, 13 ANTITRUST BULL. 177, 188-90 (1968).

sign consent decrees barring territorial restrictions . . . suggest that these are not the matter of life or death for effective distribution so often claimed."[283] Because vertical forward integration is unlikely, the public will gain from the proposed antitrust attack against features of the distribution system. The judicial demise of the location clause and the check on dealer efficiency regulation will encourage intrabrand competition in an industry whose structure has not proved to be conducive to workable interbrand competition. The anticipated increase of competitive stimuli will be achieved at little expense.

283. Zimmerman, *supra* note 258, at 1186-87.